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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 548th MEETING

Held at the Vienna International Centre, Vienna,
on Tuesday, 2 May 1995, at 2 p.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Draft Convention on Independent Guarantees and Stand-by Letters of Credit (*continued*)

Article 1 (*continued*)

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Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

V.95-58969 (E)

Distr.: 10 November 1995

The meeting was called to order at 2.05 p.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408 and A/CN.9/411)

Article 1 (*continued*) (A/CN.9/408, annex)

Paragraph 1 (*continued*)

1. **The CHAIRMAN**, speaking as representative of Singapore, associated himself with the remarks made by the German delegation at the previous meeting. The Convention could only state what it applied to and what it did not apply to, but could not dictate to the legislature of a Contracting State. However, it was to be assumed that, if a Contracting State introduced legislation to implement the Convention (or model law), it would probably comply with the requirements of the Convention.

2. **Ms. ZHANG Yuejiao** (China) shared the view of the German delegation. A convention was preferable to a model law.

3. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that, if there were no comments on the question raised by Sweden regarding the effect of the clause "unless the undertaking excludes the application of the Convention", he would assume that the Commission accepted the draft of article 1 (1) (a) as it stood.

4. *It was so agreed.*

5. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) drew the Commission's attention to the Japanese suggestion that the Convention might include a provision similar to that in article 6 of the Vienna Sales Convention. In view of the Secretary's earlier remarks on the matter and bearing in mind that the text mentioned possible choices other than those provided for in the Convention, he thought that the Commission might not wish to accept the Japanese proposal.

6. *It was so agreed.*

7. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) invited the Commission to discuss whether the product of its deliberations should be a convention or a model law.

8. **The CHAIRMAN**, speaking as representative of Singapore, asked whether the United Nations would have to convene a diplomatic conference if the text adopted took the form of a draft convention.

9. **Mr. HERRMANN** (Secretary of the Commission) said that a diplomatic conference would not necessarily have to be convened. He reminded the Commission that the General Assembly had constituted itself as a diplomatic conference to adopt the United Nations Convention on International Bills of Exchange and International Promissory Notes in 1988.

(*Mr. Herrmann, Secretary of the Commission*)

10. Informal talks had been held with those in charge of the programme of work for the Sixth Committee at the fiftieth session of the General Assembly, from which it appeared that, as consideration of one major agenda item had been postponed, there was a possibility that the draft Convention might be considered at that session.

11. **Mr. BYRNE** (United States of America) said that the Working Group has assumed that the text would take the form of a convention and not of a model law, in view of the need to harmonize international practice. The very flexibility of a model law would militate against international harmony, and a recognized legal regime was needed with regard to international instruments. The difficult and dangerous area of fraud could not be covered by means of private rules. It would be preferable to permit individual reservations rather than adopt a model law.

12. **Ms. BAZAROVA** (Russian Federation) agreed with the representative of the United States of America. When work had been begun on the text six years previously, her country had not had any legislation on independent guarantees. Since then it had been making use of the material produced by the Commission, for which it was very grateful. Internally, therefore, it no longer had any need of a model law. An international document, on the other hand, would be of assistance in dealing with international obligations. She therefore supported the adoption of a convention, particularly since the text left countries a good deal of freedom.

13. **Mr. GRANDINO RODAS** (Brazil) supported the adoption of a model law.

14. **Mr. RADWAN** (Observer for the Arab Association for International Arbitration) said that an international convention could be interpreted as the imposition of the law of the strong on the weak, especially in international trade. The history of international conventions showed that they were highly subject to amendment. It would be better to opt for a model law.

15. **Mr. STOUFFLET** (France) said that he was not completely convinced by the arguments advanced in favour of a model law. It had been said that a model law would have flexibility, but the draft was itself flexible enough. It offered the possibility of opting out on a number of points.

16. Tried and tested legal mechanisms for stand-by letters of credit and guarantees already existed. He agreed with the representative of the United States of America that what was needed was to reduce the differences between existing systems, for which purpose a convention would be preferable to a model law.

17. If understanding could not be achieved, a model law would be better than nothing, but the Commission should abide by its mandate and strive for a convention.

18. **Mr. ILLESCAS** (Spain) said the product of the Commission's work should be a convention because it would have a more unifying effect than a model law. The issue of independent guarantees and stand-by letters of credit had very serious consequences for all parties involved. At present, however, those instruments had different effects, especially for issuers, according to the country of issue. It was desirable that everyone involved in such transactions should know just where they stood, and that could not be provided for under a model law, from which countries would be free to depart. The Working Group had allowed for a reasonable degree of flexibility within the text; however, an excess of flexibility could permit mutually

(Mr. Illescas, Spain)

contradictory practices in different countries thus disappointing the expectations with regard to assurance of receipt of payment that the adoption of an international legal instrument would generate. He accordingly supported the option of a convention.

19. **Ms. ZHANG Yuejiao** (China) said that she inclined to share the opinion of the German delegation. At the same time, her delegation felt that a model law would also be acceptable. She would have difficulty supporting a convention containing final clauses which provided that there should be no reservations.

20. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that the Commission had before it a draft of final clauses (A/CN.9/411) prepared by the Secretariat, which still had to be discussed. The provision referred to by the Chinese representative was an interpretation of an existing principle of international treaty law that reservations were not allowed unless they were specifically provided for. It remained to be seen whether the Commission would adopt it or not.

21. **Mr. ADENSAMER** (Austria) considered that the rules should take the form of a convention.

22. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that the text as it stood would provide sufficient flexibility for those countries that would prefer a model law if it were adopted as a convention.

23. **Mr. VASSEUR** (Observer for Monaco), referring to the draft final clause ruling out the possibility of making reservations, said that, though that clause had not yet been adopted, he understood that there was not much chance of its being modified. Other recent UNCITRAL texts had had similar clauses. It was therefore not possible to proceed on the assumption that if the text took the form of a convention, States preferring the model law form would be able to make reservations.

24. **Ms. ASTOLA** (Finland) said that Finland had always been in favour of a convention. Despite the danger that it might not be ratified, a convention was still preferable to a model law.

25. **Ms. JASZCZYNSKA** (Poland) said that Poland was in favour of a convention.

26. **Mr. EDWARDS** (Australia) said he was in favour of the Working Group's recommendation for a convention. A model law would result in a large number of differences between national laws and would not contribute to harmonization. The most important thing was to achieve real certainty on key issues, a certainty that did not at present exist.

27. **Mr. FAYERS** (United Kingdom) said that the United Kingdom would have preferred a model law, but had been persuaded by the argument that a convention would promote the harmonization of international banking practices. Though the freedom allowed by a model law might enable it to win greater acceptance, the text as it stood offered a great deal of flexibility.

28. **Mr. OGARRIO** (Mexico) and **Mr. LAMBERTZ** (Observer for Sweden) expressed their support for a convention.

29. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) took it that the Commission agreed that the text should take the form of a convention.

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30. **Mr. MARKUS** (Observer for Switzerland) said that paragraph (1) (b) should be deleted since it added nothing to the text and might lead to difficulties in practice. The purpose of paragraph (1) (b) was to extend the international field of application of the Convention, but it did not in fact do so, because it had exactly the same connecting factor as paragraph (1) (a). In his view, it would make no difference whether paragraph (1) (b) were deleted or not, except in the case of a choice of law, but in that case it would be more appropriate and simple to add an opt-in clause to the already existing opt-out clause.

31. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that paragraph (1) (b) was an important provision as it dealt with the scope of the Convention, the aim of which was to harmonize international trade law. As the phrase "unless the undertaking excludes the application of the Convention" appeared to make it possible for parties to circumvent the terms of the Convention, he proposed its deletion.

32. **Ms. CZERWENKA** (Germany) supported the suggestion made by the observer for Switzerland. When the issue of reservations to the Convention came to be discussed, it might be necessary to refer to paragraph (1) (b) if that article were left as it stood. What seemed a perfectly straightforward matter might become much more complicated if the Commission later decided to allow reservations. For the sake of simplicity, it would therefore be preferable to delete paragraph (1) (b).

33. **Mr. FAYERS** (United Kingdom) said that in his view, paragraph (1) (b) was intended to and did in fact add something to paragraph (1) (a). Indeed those who had drafted the Vienna Sales Convention had come to the conclusion that a similar provision was necessary. However, it might nevertheless be preferable to delete paragraph (1) (b), because it merely stated what the judge would do in any case. If it were retained, it would be necessary to consider carefully the wording in paragraph (3).

34. **Mr. HERRMANN** (Secretary of the Commission) said that the main reason given for deleting paragraph (1) (b) was that it simply stated what happened in any case. But the fact that a provision was redundant had not in the past prevented the Commission from including it. What might be self evident for some people was not necessarily self-evident for everybody. Moreover, leaving something out because it was self-evident might lead people to draw the wrong conclusions. In contrast to the Vienna Sales Convention, the present draft Convention contained a rule on conflict of laws. The provision in question did not state what rule of private international law led to the application of the law of a Contracting State. The Convention might apply as a result of a positive choice of law. He observed that the application of paragraph (1) (b) had a much narrower scope in practice than the corresponding provision in the Sales Convention owing to the conflict of laws rule in article 21. But despite its more limited practical application, it would be wrong to conclude that it had no effect at all.

35. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), seeing no further support for the suggestion made by the observer for Switzerland, took it that the Commission wished to retain the text as it stood.

The meeting was suspended at 3.25 p.m. and resumed at 3.50 p.m.

Paragraph 2

36. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), introducing article 1 (2), said that the Working Group had explored several approaches concerning what might be called an opting-in type of provision for commercial letters of credit, but had eventually focused on a way of bridging the differences

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(Mr. Gauthier, Chairman of the Committee of the Whole)

between of independent guarantees and stand-by letters of credit and developed a set of uniform rules that would cover both fields. Basically, the present text stipulated that if those using letters of credit other than stand-by letters of credit wanted the Convention to apply, they must say so.

37. **Mr. VELEZ-RODRIGUEZ** (Observer for the International Chamber of Commerce) said that, in the view of his organization, articles 1 (2) and 20 constituted a threat to the stability of well-established international practices. Bank guarantees and stand-by letters of credit were contracts between issuers and beneficiaries that were linked to, but independent of, contracts between applicants and beneficiaries. Such instruments functioned relatively uniformly and smoothly throughout the world, despite the absence of comparable statutory rules in many countries. International practice was reflected in existing ICC rules such as the Uniform Customs and Practice for Documentary Credits (UCP) and the Uniform Rules for Demand Guarantees (URDG). By adopting minimally acceptable rules, the draft Convention failed to add anything to URDG or UCP practices except in the case of fraud and provisional court measures. Indeed, by interfering with well-established international practice through the opting-in provision for documentary letters of credit (article 1, paragraph (2)), the text gave rise to serious concern for various reasons. Firstly, under article 2, paragraph (1), only undertakings payable either upon simple demand or upon presentation of other documents were subject to the draft Convention, whereas in practice many undertakings were payable upon presentation of a demand together with other specific documents. Secondly, article 8, paragraph (2), could affect revocable as well as irrevocable undertakings, whereas international practice allowed a revocable undertaking to be amended up to the moment at which the beneficiary made a demand. Thirdly, references in the draft Convention to the "principal applicant" implied that undertakings were in certain respects ancillary to acts or omissions of the applicant, while international practice was founded on complete independence, subject only to the principle *fraus omnia corrumpit*. Fourthly, according to international practice, all terms and conditions of an undertaking had to be embodied in the instrument itself or in any formal amendments thereof, but the draft Convention stated at several points that "the guarantor/issuer and beneficiary may agree elsewhere". Fifthly, the ban on "eternal" undertakings in article 12, paragraph (c), did not conform with international practice, which in some cases allowed the absence of a termination date. Lastly, under certain circumstances specified in article 19, paragraph (1), the issuer was obliged not to honour a demand made despite the fact that international practice allowed the bank discretion to honour its commitment for its own reasons. Moreover, in the case of alleged fraud in the underlying transaction, an issuer having contractual relations with both the applicant and the beneficiary must, in international practice, remain neutral, in contrast to article 19 (1) (b) (ii) of the draft Convention. He concluded by asking the Commission to draw the consequences from his comments and delete article 1 (2).

38. **Ms. CZERWENKA** (Germany) said that her delegation would also favour deleting article 1, paragraph (2). It dealt with a situation where the Convention usually did not apply but parties to an undertaking decided it should. That was outside the scope of application of the Convention and therefore should not be dealt with in the text. Furthermore, the paragraph gave the false impression that the Convention dealt with something other than the undertakings defined in article 2.

39. If the Commission wished to retain the text, it should be redrafted. Either paragraph (1) should state that the Convention applied to stand-by letters of credit, but that other instruments could be opted in as well, or it should state that the Convention applied also to international letters of credit other than those undertakings referred to in article 2.

40. **Mr. KOZOLCHYK** (United States of America) said that there was no real inconsistency between the Uniform Customs and Practice for Documentary Credits (UCP) and paragraph (2). The rules were not meant to contradict anything in the UCP, but rather to supplement it with provisions not covered by it because of its nature. Being customary rules, the UCP could not tell a bank as of which moment its own law required it to be bound by its promise. In many countries where the UCP had been adopted, that could be any one of several different moments in time under local law, and the UCP could do nothing about it because the UCP could not change local law. The Convention could, however, and it did so in a manner consistent with the spirit of the institution.

41. If the basic premise was that the Convention set forth rules of traffic and remedial rules which were not found in the UCP, what was wrong with combining them? There might be transactions that had both a UCP letter of credit and a bank guarantee or stand-by letter of credit covered by the Convention and which stated that the Convention applied. In such cases, two different laws would have to be applied for each part of the transaction, and none of the remedies in the Convention, consistent though they were with the UCP part of the transaction, would be applicable.

42. **Mr. MARKUS** (Observer for Switzerland) said that he also favoured deleting paragraph (2), for three reasons. First of all, in drafting the Convention, the Working Group had concentrated on stand-by letters of credit and bank guarantees, and he doubted that commercial letters of credit had been sufficiently considered. Secondly, the opting-in clause was of a somewhat uncertain legal nature. Thirdly, the notion of "letter of credit" itself was quite unclear, as it was never defined in the Convention. It could be understood very differently in different countries, raising uncertainty as to the entire scope of application of the Convention.

43. **Mr. SHISHIDO** (Japan) also felt that the paragraph should be deleted, not because Japan would find it difficult to include commercial letters of credit in the Convention, but because of the problem of drafting. Since there was no definition of letters of credit, it was not clear which letters of credit could be opted in. In any case, there was no need for the paragraph to include commercial letters of credit, as article 2 did not exclude such letters from the definition of "undertaking" and, under the rule of party autonomy, any of the Convention's provisions could be applied to them.

44. **Mr. FAYERS** (United Kingdom) said that the banks in his country apparently saw no objection to having a provision such as paragraph (2), which would provide their customers with that option if that was what they wanted. The Convention and the UCP were complementary, although some of the provisions of the former were inconsistent with the latter. If the parties were to apply the Convention to their letters of credit, that would entail considerable expense in consulting lawyers on a number of difficult questions. However, he saw no reason in principle why the facility should not be offered to people wishing to contract into the Convention, and he had no objection to retaining the provision. Just because it was not necessary to state something in law did not mean it should not be stated.

45. If the provision were deleted, however, under his country's law it would be possible for the parties to so construct their commercial letters of credit that the provisions of the Convention, in whole or in part, would apply to them. That option — "in whole or in part" — should be available to the parties, and was even more important if some of the provisions were not consistent with the UCP.

46. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that paragraph (2) broadened the scope of application of the Convention and was misleading. It should be deleted.

47. **Mr. VASSEUR** (Observer for Monaco) said that the Banking Federation of the European Union had been greatly surprised by paragraph (2), and had not seen it as complementing the UCP. He asked how anyone could think that banks throughout the world which had adopted the UCP either through banking associations or individually would also want to apply the rules of the Convention. The paragraph was causing some consternation for almost all banks, and none of the associations within the Federation had been in favour of it.

48. **Mr. KOZOLCHYK** (United States of America) said it was difficult to imagine how anyone could oppose the idea of allowing a bank to issue a commercial letter of credit subject to the Convention or why anyone should be afraid to allow the parties to choose to do so. The difficulties which had been raised with respect to paragraph (2) concerned, rather, its formulation, meaning and clarity. The text represented a necessary compromise, because it had proved impossible to define a stand-by letter of credit. Another solution would be to take the opposite approach and expand the scope of the Convention to include commercial letters of credit, allowing the parties to opt out. For commercial letters of credit in the international sphere, there were many advantages to allowing the optional application of the Convention. It provided certainty of a legal sort, which could not be provided in rules, about when the undertaking was effective and the meaning of definitions. It provided definitive rules for the first time of an enlightened and progressive nature on the assignment of proceeds — an issue which the UCP did not and could not cover, because it was a matter for law and not for practice — and on fraud and injunctions.

49. Fraud increasingly dominated the field of commercial and stand-by letters of credit. That would have an impact on applications for extraordinary relief, as to which there was neither an international regime nor international harmony, with respect either to the rules to be applied or to the standard to be used. In that regard, the Convention offered a useful safe harbour for issuers of international letters of credit as well as beneficiaries and applicants, enabling them to know what the regime or standard would be with respect to fraud and extraordinary or injunctive relief.

50. The Convention further provided clear rules on the legal effect of transfer and on set-off and choice of law, which could not be provided by any system of private rules. There was no competition between the Convention and any private regime of rules: the provisions themselves were not in conflict, and they allowed enough flexibility so that the parties could choose to opt out; if there were a conflict, a UCP rule would take precedence over the rule of the Convention. There was nothing in the Convention which contradicted sound banking practice, and the United States banking community, which favoured the inclusion of the provision as at present drafted, felt that it would actually help to promote sound banking practice.

51. As to whether the existence of an international legal regime supplementing private rules of practice would defeat the aim of facilitating trade, his country's experience was that, where there was an express provision in positive law on letters of credit, which supplemented rules of practice such as the UCP, that had an enormous positive effect on the willingness of lawyers and courts to encourage the use of commercial as well as stand-by letters of credit and had provided additional certainty. Many of the arguments put forward against specific provisions of the Convention in relation to commercial letters of credit would be equally valid in relation to guarantees and stand-by letters of credit and would imply that the Convention should not be adopted at all for any instrument. That would be true as well under the Uniform Rules for Demand Guarantees (URDG), with respect to guarantees, and under the UCP, with respect to stand-by letters of credit.

(Mr. Kozolchyk, United States of America)

52. His delegation could agree to a provision which dropped any reference to stand-by letters of credit and indicated that the parties could adopt the Convention with regard to any independent international undertaking, which might avoid some of the problems of definition. But if felt that the Convention should be available for parties in an international commercial transaction and that the text should say so. He asked whether the Secretariat felt the provision was unnecessary.

53. **Mr. ILLESCAS** (Spain) said he saw a great deal of merit in the comments by the representative of the United States of America. Situations did indeed arise in which a letter of credit was backed up by a counter letter of credit, or by a guarantee of due performance for a commercial letter of credit. In such situations, submitting a commercial letter of credit to a different rule from that governing a letter of credit or guarantee on first demand would be a complicated process, which would be at variance with the Convention's objective of achieving uniformity. As drafted, paragraph (2), rather than helping to resolve the conflict, contributed to the confusion through its specific reference to international letters of credit, which were governed by the UCP. The solution might be to find another term which would have the same scope. It must be clear that parties could submit letters of credit other than stand-by letters of credit to the rule if they wished.

54. **Mr. AL-NASSER** (Saudi Arabia) said that his country's banks and chambers of commerce, had discussed paragraph (2) and had concluded that it was ambiguous; some had even thought that it provided a choice between applying the rules of the International Chamber of Commerce and applying those of the Convention. Like the representative of Spain, he believed the paragraph should be reworded in order to dispel its ambiguity. Its effect should be to refer only to documentary credits. In the absence of satisfactory new wording, the paragraph should be deleted.

55. **Mr. LAMBERTZ** (Observer for Sweden) said it seemed the general view that a bank should be able to issue a guarantee or a stand-by letter of credit governed by the Convention, and that the Convention should say so expressly — not because that was necessary, but because it would be useful. If the present wording was misleading, an acceptable solution might be to adopt the suggestion made by Germany to replace the reference to an international letter of credit other than a stand-by letter of credit by a reference to all undertakings not covered by article 2. Paragraph (2) would then read along the following lines: "This Convention applies also to undertakings other than those referred to in article 2 if they expressly state that they are subject to the Convention".

56. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the expression "international letter of credit other than a stand-by letter of credit" had been adopted by the Working Group as being the only alternative to the term "undertaking" itself. If the German suggestion was adopted, the text would become meaningless, since an "undertaking" was something defined in article 2, and therefore the "undertaking" in article 1 (2) — in effect an undertaking "other than an undertaking" — would not be an undertaking within the meaning of the Convention.

57. **Ms. ZHANG Yuejiao** (China) was in favour of keeping paragraph (2), which had the virtue of flexibility.

58. **Ms. BAZAROVA** (Russian Federation) said that paragraph (2) aimed at permitting issuers of commercial letters of credit to apply the Convention to those instruments. She therefore favoured its inclusion, although the text could be worded more clearly. She endorsed the observations of Spain and Saudi Arabia on that point.

59. **Ms. ASTOLA** (Finland) said that her delegation could accept the article with or without paragraph (2). If it was retained it might usefully be redrafted. She found merit in the German suggestion, which as she understood it, was that the paragraph would refer to an international letter of credit other than that defined in article 2, not that it would refer to undertakings other than those defined in the Convention. A simple alternative would be to say that the Convention applied also to a commercial letter of credit if the document so stated. That would avoid the problems raised by linking paragraph (2) to article 2.

60. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted the general agreement that paragraph (2) was acceptable in its principle — namely, that the Convention could be applied to commercial letters of credit by means of a stipulation in the instrument to that effect — as well as the idea that its text should be clarified. As to the exact wording, the approach suggested by the representative of Germany was to speak of an international letter of credit other than an undertaking as defined in article 2. Unless he heard any objection, he would take it that the Commission referred the paragraph to the drafting group on that understanding.

61. *It was so agreed.*

The meeting rose at 5.05 p.m.

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on Wednesday, 3 May 1995, at 9.30 a.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

CONTENTS

Draft Convention on Independent Guarantees and Stand-by Letters of Credit (*continued*)

Article 1 (*continued*)

Article 2

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Distr.: 13 November 1995

The meeting was called to order at 9.35 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 1 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that paragraph (3) of article 1 was intended to indicate that the two provisions on conflict of laws would apply even if the international undertaking was not covered by paragraph (1).

2. **Mr. EDWARDS** (Australia) said his delegation would prefer the reader of article 1 to have his attention immediately drawn to the fact that exclusion of the application of the Convention could not apply to the choice of law regime referred to in articles 21 and 22. That should be made clear in paragraph (1).

3. **Mr. SHISHIDO** (Japan) asked whether the internationality of the undertakings referred to in paragraph (3) was the same as that defined by article 4. He also wondered whether an international letter of credit other than a stand-by letter of credit, as referred to in paragraph (2), was also included in the undertakings referred to in paragraph (3).

4. **Mr. HERRMANN** (Secretary of the Commission) said that the term "international" would have to be understood as defined in article 4. But whether that was the correct definition with respect to the scope of application of articles 21 and 22 was another matter. The question of choosing between the laws of different States arose in a general international context, for which the definition in article 4 might be too narrow. If so, the remedy would be to include an appropriate definition in articles 21 and 22. Paragraph (3) as at present drafted was a negative rule; the language could alternatively be drafted in positive terms by stating that the rule of article 1, paragraph (1), defining the scope of application applied only to articles 2 to 20.

5. As to the second question raised by Japan, the undertakings to which article 1, paragraph (3), and all other provisions of the Convention applied were those defined in article 2. It had been specifically decided that article 2 should not include commercial letters of credit. The term "undertaking" as used anywhere in the Convention, therefore, did not as such apply to them. The provisions were, however, drafted in such a way that they could be applied to commercial letters of credit if the parties so desired. It was then up to them to opt in, under article 1, paragraph (2). If it was wished to have a Convention that applied specifically to such instruments from the outset, the text would have to be redrafted.

6. **Mr. SHIMIZU** (Japan) said he could not understand the logical basis for the application of the Convention. It was designed to apply to the undertakings defined in article 2, but could be extended to other instruments not covered by that article. For the undertakings defined in article 2 to be governed by the Convention, it would not suffice for the parties to state that they wanted it to apply, because the conditions set forth in paragraph (1) (a) and (b) would also have to be met. With commercial or other letters of credit, on the other hand, it would suffice for the parties to state expressly that they wished for the application of the Convention; the conditions in paragraph (1) (a) and (b) would not have to be met.

7. **Mr. HERRMANN** (Secretary of the Commission) said that it would be impossible to specify all types of instruments that could possibly be brought under the umbrella of the Convention by choice of the parties, as the Commission did not even know all the types in existence. Whatever types of instruments might be mentioned, that would not mean that other types could not be opted in. When the parties chose to opt in, that was a matter for them. There was no reason why the conditions in paragraph (1) (a) and (b) should be met if the parties did not think it necessary. That was only necessary if the Convention was to apply automatically under article 1, paragraph (1).

8. **Ms. CZERWENKA** (Germany) said she was in favour of redrafting the article, as paragraph (3) sounded adversarial in its present wording. It would be preferable to have a positive wording regarding the scope of application of articles 21 and 22. Thus paragraph (1) might begin "This Convention applies to an international undertaking referred to in article 2; articles 5 to 20, however, only:". Subparagraphs (a) and (b) would follow, and paragraph (3) would then be deleted. As to the term "international", it would cause problems to have two definitions. The only definition should be the one in article 4, which should also apply with regard to the application of articles 21 and 22.

9. **Mr. FAYERS** (United Kingdom) said that article 1, paragraph (3), was intended to let the judge know which private international law principles he should apply when paragraph (1) (b) was at issue. Paragraph (3) could be redrafted to state that for the purposes of paragraph (1) (b), the rules of private international law would be those set out in articles 21 and 22; it was not necessary to continue with the phrase "irrespective of whether or not in any given case the Convention applies pursuant to paragraph (1) of this article".

10. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that paragraph (3) was in fact intended to be broader than the representative of the United Kingdom had indicated. The text was not just a further explanation of how to understand paragraph (1) (b).

11. **Mr. HERRMANN** (Secretary of the Commission) said that articles 21 and 22 were like a second Convention; they constituted an independent set of rules for a court in a Contracting State if the question of conflict of laws arose. Where the place of business of the guarantor/issuer was not in a Contracting State, but there was an international context, it was necessary to know which law to apply. In article 22, there was a positive and binding rule of private international law which must be applied by the court in a Contracting State and was also binding if it led to the law of a non-Contracting State.

12. **Mr. CHOUKRI SBAI** (Observer for Morocco) proposed the following wording for the text: "Notwithstanding the rules of the Convention, the provisions of articles 21 and 22 apply to international undertakings as defined in article 2."

13. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said the Commission did not seem to be opposed to the objective of paragraph (3) but to feel that it could be stated more clearly. It might be that the text could not be significantly altered without modifying the principle behind it. However, he took it that the Commission wished to record its agreement as to the substance and to ask the drafting group to explore ways of improving the text.

14. *It was so decided.*

Article 2 (A/CN.9/408, annex)

15. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) called for comments on paragraph (1).

16. **Mr. HERRMANN** (Secretary of the Commission) drew attention to the fact that the phrase "or upon presentation of other documents" in the fourth line had been added fairly recently in order to make it clear that the demand must itself take the form of a document. The Working Group had not wanted an instrument that would allow an oral demand to suffice. The question of oral demands had been discussed at an early stage in the work, and it had been suggested that the text should include an explicit rule declaring an oral demand alone to be invalid. According to the current draft, an instrument allowing an oral demand would not fall within the Convention's scope of application. Referring them to a query raised by the ICC, he said that the common case of a demand accompanied by some documents could be clearly covered, if there was a need for more clarity, by replacing the word "other" by the word "additional".

17. **Mr. CHOUKRI SBAI** (Observer for Morocco) suggested, firstly, that in view of its length and range of content, article 2 should be split into two separate articles, the first containing the definition of an undertaking, as in the present paragraph (1), and the second dealing with questions of substance and payment. It would then be possible to expand the definition of an undertaking. Secondly, he proposed that the word "immediately" be added after the words "to pay" in the third line of paragraph (1). Moreover, since the phrase "upon simple demand" might be ambiguous, the demand should be considered valid only if submitted within the period laid down in article 12 (c), that is to say, six years. In other words, payment should be immediate if the demand was submitted in time. Thirdly, he suggested adding an extra paragraph to the effect that the objective of the undertaking must be defined: the beneficiary could have several objectives and aims, whereas a letter of credit was issued for a single objective, which should therefore be stated in the guarantee, in order to avoid disputes or conflicts.

18. **Mr. FAYERS** (United Kingdom) said that although it seemed that the United Kingdom and the ICC were alone in interpreting the phrase "upon simple demand or upon presentation of other documents" as not including demands needing to be accompanied by other documents, he would like the drafting group to be authorized to add words that would make it clear that such documents were in fact included.

19. **Mr. STOUFFLET** (France) said that article 2, paragraph (1), listed certain categories of institutions or persons able to issue an independent commitment. Although the Secretary had assured the Commission that the listing did not carry any implication in regard to capacity or authority to give such an independent commitment, he felt that it would be preferable to insert the words "authorized to do so according to the law to which it or he is subject" after the words "other institution or person ('guarantor/issuer')".

20. **Mr. AL-NASSER** (Saudi Arabia) said that representatives of Saudi Arabian banks had misgivings concerning the institutions authorized to issue independent commitments. He therefore supported the amendment proposed by the representative of France.

21. **Ms. FENG Aimin** (China) expressed her agreement with the explanation offered by the Secretary, but asked for clarification with reference to article 19.

22. **Mr. SHISHIDO** (Japan) asked whether or not article 2 excluded commercial letters of credit. Secondly, he wondered whether it would be possible to delete the words "usually referred to as an independent guarantee or as a stand-by letter of credit", since that terminology did not exist in Japanese law and would cause problems.

23. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that a proper definition was very important for the independence of the commitment. It had to be independent of the link between the principal and the bank or guarantor as well as of that between the principal and the beneficiary. To ensure that the guarantee led to immediate payment of a certain sum to satisfy the objective in question, there must be no sign of any linkage.

24. **Mr. KOZOLCHYK** (United States of America), referring to the question of an oral demand, said that two possible situations could arise. Firstly, an oral demand might be expressly required, but that happened so rarely that there was no need for the Convention to prohibit such an undertaking. Secondly, the wording of an undertaking might be ambiguous, calling only for a "demand" without specifying that it needed to be in writing. In his view, however, that possibility was covered by article 15 and therefore did not need to be addressed. He expressed his support for the request made by the representative of the United Kingdom that the drafting group should be asked to find a form of words to cover the apparent gap created when a demand was accompanied by additional documents. As for the proposal put forward by the representatives of France and Saudi Arabia, he agreed in principle with their position, but considered that the question should be approached in such a way that it did not give rise to a possible defence based on *ultra vires* or lack of authority by the issuer. The wording proposed by the representative of France might allow room for such a defence. Should the Commission decide to deal with the question, it might be preferable to include an affirmative statement to the effect that the Convention itself did not give the authority to issue such an undertaking.

The meeting was suspended at 10.50 a.m. and resumed at 11.20 a.m.

25. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), referring to the question of whether to include wording regarding capacity to enter into the commitments covered by the text, noted that some considered such wording would be acceptable as long as it did not give rise to a defence of *ultra vires*. In his view, the defence that someone was incapable at law always existed and the text did not grant or deny capacity. However, if wording on capacity was to be included, the question would have to be discussed in greater detail. He asked members to give careful thought to that matter before amending the text.

26. A suggestion had been made to include a description of the purpose for which the instrument was issued. That possibility had been examined by the Working Group, but had been considered divisive and unlikely to receive support.

27. Turning to the proposed amendments, he said that on the question of "simple demand" it was not the Working Group's intention to exclude demands accompanied by documents. It seemed, however, that it was possible to construe the present drafting, in English at least, as meaning that such a demand would not be an undertaking within the terms of the Convention. He suggested that the matter be referred to the drafting group to ensure that that risk was eliminated.

28. *It was so agreed.*

29. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) drew attention to the point raised concerning oral demands. His understanding was that they were not covered by the Convention. After inviting comment, he noted that there did not seem to be any support for including a provision in the Convention to regulate such demands.

30. After inviting comment, he noted that there did not seem to be any support for the proposal to include the word "immediately" before "pay to the beneficiary".

31. After inviting comment, he noted that there did not seem to be any support for the proposal to include, after the word "person", the words "having the legal capacity in accordance with the law of the country applicable to that person".

32. After inviting comment, he noted that there did not seem to be any support for the proposal to introduce a term describing the purpose for which the instrument was issued.

33. On the question of whether commercial letters of credit were covered by article 2, he understood that, given the context of the whole Convention — including article 1 (2)—and the words "usually referred to as an independent guarantee or as a stand-by letter of credit", commercial letters of credit were not automatically covered. For them to be covered, the parties would have to make the fact explicit in the undertaking.

34. As to the suggestion that the terms "independent guarantee" or "stand-by letter of credit" might not be clear because they were not widely used in certain market-places, he pointed out that was why the word "usually" had been included.

35. He asked whether there was support for the deletion of the words "usually referred to as an independent guarantee or as a stand-by letter of credit".

36. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that since the independence of the undertaking was defined in article 3, there should be no problem with the wording of article 2 (1).

37. **Mr. SHISHIDO** (Japan) said that his delegation's problem was not with the terms "independent guarantee" or "stand-by letter of credit", but with the words "usually referred to as". However, Japanese legal requirements would be met if the issuer were required to use the words "independent guarantee" or "stand-by letter of credit".

38. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that his country too would have problems with the word "usually", which was not a legal term. Perhaps the wording "an undertaking is an independent commitment referring to an independent guarantee or stand-by letter of credit" might meet the case.

39. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) observed that the reason for the inclusion by the Working Group of the words "usually referred to as" was that at one time the words "in the form of a bank guarantee or stand-by letter of credit" had been considered and rejected, because it had been realized that there was no agreed form used in banking circles. The Working Group had then looked at the concept known as the "safe haven", which meant that to be covered by the Convention the instrument would have to be formally entitled "independent guarantee" or "stand-by letter of credit". That solution has

(*Mr. Gauthier, Chairman of the Committee of the Whole*)

been considered unsatisfactory by the Working Group because again there was no formula in widespread use. The word "usually" had therefore been included to take account of market practice.

40. **Mr. FAYERS** (United Kingdom) proposed that in article 2, paragraph (1), the words "usually referred to as" be replaced by "commonly known as".

41. **Mr. CHOUKRI SBAI** (Observer for Morocco) pointed out that the use of the terms "independent guarantee" and "stand-by letter of credit" appeared in the title of the draft Convention. The way those terms were used, moreover, varied from country to country. Hence, the specific reference to them in paragraph (1) of article 2 was both superfluous and open to ambiguous interpretation. He therefore suggested that the words "usually referred to as an independent guarantee or as a stand-by letter of credit" be omitted.

42. **Ms. BAZAROVA** (Russian Federation) said that the word "usually" had a clear meaning in the Russian language. She felt that its deletion from article 2, paragraph (1), would avoid the problem of different usages of the terms in some countries. It was standard practice in the Russian Federation to refer to letters of credit.

43. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) warned that, if the adverb "usually" were deleted, the verb "referred to" could imply that the undertaking necessarily bore a specific heading. He suggested that the Commission might consider adopting the expression "commonly known as", as proposed by the United Kingdom representative.

44. **Mr. EDWARDS** (Australia) said that, while he could go along with the expression "commonly known as", it implied wide acceptance, which was not the case in some civil-law countries. He therefore suggested that "known in some legal systems as" might be a suitable alternative.

45. **Ms. ZHANG Yuejiao** (China) considered that, because the expression "commonly known as" was capable of different interpretations, it would be difficult to make a judgement on the matter.

46. **Mr. FAYERS** (United Kingdom), referring to the remarks made by the representative of Australia, said that, since an undertaking was commonly known in the market as an independent guarantee or a stand-by letter of credit, perhaps the phrase "in the ordinary course of business known as" might be a more appropriate formulation.

47. **Mr. ILLESCAS** (Spain) said that, in the Spanish version of article 2, paragraph (1), the phrase "*conocida en la práctica como*" ("known in practice as"), was used to render the English words "usually referred to". It had the dual merit of avoiding the problematic adverb "usually" and of referring to the context of business dealings in a general sense. The English phrasing could possibly be brought into line with the Spanish text at that point.

48. **Mr. CHOUKRI SBAI** (Observer for Morocco) wondered whether the problem presented by the word "usually" might be overcome by its inclusion in a footnote or square brackets.

49. **Mr. LAMBERTZ** (Observer for Sweden) said that he favoured the wording "in the ordinary course of business", suggested by the United Kingdom representative, since it made a reference to market practice while avoiding the definition of an absolute rule. He felt that the matter might be left to the drafting group.

50. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that, on the basis of past experience, he would prefer the Commission to find an acceptable solution itself rather than refer the matter to the drafting group.

51. **Mr. AL-ZEID** (Observer for Kuwait) said that the proposed replacement of "usually referred to as" by "commonly known as" was not fully satisfactory as far as the Arabic version was concerned. He agreed with the representative of Japan and the observer for Morocco that the phrase "usually referred to as ... credit" was both superfluous and potentially confusing. If that phrase were deleted, the definition of undertaking in article 2, paragraph (1), would remain sufficiently clear and encompass other commercial letters of credit.

52. **Mr. SHISHIDO** (Japan), while expressing a preference for the expression "in the ordinary course of business", said that the addition of a phrase that defined the area of jurisdiction applicable would render the formulation more acceptable in Japanese law.

53. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the Commission was concerned rather with the concept of a widely-shared practice in the international market-place. Attempts to narrow the definition to the practice of a particular group, such as lawyers or other specialists, should be avoided.

54. **Mr. STOUFFLET** (France) said that reference to international practice in a text for application at the level of States was inadvisable. The term "demand guarantee", which was employed in uniform rules drawn up by the ICC, a body recognized as a qualified interpreter of practice, could perhaps be added to the terms "independent guarantee" and "stand-by letter of credit".

The meeting rose at 12.30 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 550th MEETING

Held at the Vienna International Centre, Vienna,
on Wednesday, 3 May 1995, at 2 p.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Corrections should be submitted in one of the working languages. They should be set forth in a memorandum and also incorporated in a copy of the record. They should be sent *within one week of the date of distribution of this document* to the Secretary of the Commission, room E0455, Vienna International Centre.

Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

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The meeting was called to order at 2.05 p.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408 and A/CN.9/411)

Article 2 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that there was support for the replacement of the phrase "usually referred to as an independent guarantee or as a stand-by letter of credit" in paragraph (1) by the phrase "known in international practice as an independent guarantee or stand-by letter of credit" and for the retention of paragraphs (2), (3) and (4) as drafted.

2. *It was so agreed.*

Article 3 (A/CN.9/408, annex)

3. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) invited the Commission to consider article 3, which described the circumstances under which an undertaking could be considered as independent.

4. **Mr. VASSEUR** (Observer for Monaco) said he thought that there was an inconsistency between the provision in article 3 that "an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not subject to the existence or validity of an underlying transaction" and the provision in paragraph (2) of article 19, which mentioned "types of situations in which a demand has no conceivable basis" and quoted as an example in its subparagraph (b) a situation in which "the underlying obligation of the principal/applicant has been declared invalid by a court".

5. **Mr. FAYERS** (United Kingdom) shared that misgiving and suggested that the difficulty might be solved by adding the words "and subject to article 19" before the words "an undertaking is independent" in the first sentence of the article. That would indicate that articles 3 and 19 were related.

6. **Mr. BYRNE** (United States of America) said that he appreciated the issue raised by the observer for Monaco but thought that the purpose of article 3 was to define the notion of independence in order to determine the scope of the Convention. For that purpose, even though an independent undertaking within the Convention existed, it might conceivably be declared pursuant to article 19 to be an independent obligation entailing no obligation to pay because of the presence of fraud. The suggestion made by the United Kingdom would mean that an independent guarantee tainted by fraud would be outside the scope of the Convention, which would be inadvisable, since the purpose of article 19 was to provide a system of regulation where fraud was alleged.

7. **Mr. SHISHIDO** (Japan) supported the proposal made by the United Kingdom.

8. **Mr. HERRMANN** (Secretary of the Commission) said that the purpose of article 3 was to distinguish between those instruments in respect of which a payment obligation under a guarantee depended directly on the validity of an underlying obligation and those in which it did not. However, that should not be construed as implying that an underlying obligation was irrelevant. For instance, a positive statement of non-performance by the principal/applicant would clearly be relevant.

(*Mr. Herrmann, Secretary of the Commission*)

9. However, inclusion of the words "subject to" would not clarify the meaning, but might lead to confusion. The text as drafted introduced important progress by severing a direct link and making it indirect and documentary.

10. **Mr. FAYERS** (United Kingdom) withdrew his proposal to add the words "subject to" in the first line of the article. He thanked the Secretary for his explanations and suggested that the phrase "is not subject to" in the second line be replaced by the words "is not dependent upon" and that the words "is not subject" be added before the words "to any term or condition" in the fourth line of the article.

11. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that the term "subject to" would lead to confusion in Arabic. He would therefore prefer the expression "linked to" or "dependent on". In both French and Arabic, the use of the term "dependent upon", as proposed by the United Kingdom, would be correct.

12. **The CHAIRMAN**, speaking in his capacity as the representative of Singapore, supported the United Kingdom proposal.

13. **Mr. OGARRIO** (Mexico) supported the United Kingdom proposal, the Spanish version of which expressed much more clearly the idea explained by the Secretary.

14. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) asked the Commission whether it wished to accept the amendment proposed by the United Kingdom.

15. *It was so decided.*

Article 4 (A/CN.9/408, annex)

16. **Mr. MARKUS** (Observer for Switzerland) mentioned some concerns that he shared with the Observer for Sweden.

17. Firstly, there was no rule to cover the rare but possible case that the undertaking did not expressly indicate one or more of the places of business involved.

18. Secondly, there was no clarity regarding the case where the undertaking specified an objectively wrong place of business. The question was whether the decisive place of business would be the real place of business or the place of business indicated in the undertaking, i.e., objectively, the wrong one. If the latter were the case, the parties would be given the possibility of opting-in by indicating an objectively wrong place of business, which was not satisfactory. Opting-in should be allowed exclusively by means of the mechanism mentioned in article 1.

19. Thirdly, since the concept of habitual residence had not been mentioned elsewhere in the draft, it should not be introduced in the context of internationality.

Mr. Markus, Observer for Switzerland

20. He therefore proposed that paragraph (1) be amended to read:

"(1) An undertaking is international if the places of business of any two of the following persons are in different States and if these places are specified in the undertaking: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer."

21. Paragraph (2) (b) should be deleted and the entire paragraph (2) should read:

"(2) If the undertaking lists more than one place of business for a given person, the relevant place of business is that which has the closest relationship to the undertaking."

22. **Mr. KOZOLCHYK** (United States of America) asked if the term "beneficiary" in paragraph (1) included the transferee. If it did not, it would be necessary to include the transferee as one of the persons whose presence might be relevant to the internationality of an undertaking. He also suggested including the assignee of proceeds because as long as the presence of either one of the parties could lead to a dispute, there would be every reason to apply the Convention.

23. **Mr. FAYERS** (United Kingdom) asked why the word "confirmer" had been added at the end of paragraph (1). He pointed out that according to article (6) (b), the term "guarantor/issuer" included "counter-guarantor" and "confirmer". Therefore either "counter-guarantor" should be inserted or "confirmer" should be deleted.

24. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) pointed out that the Working Group on International Contract Practices had referred in paragraphs 92 and 93 of the report on the work of its twenty-second session (A/CN.9/405) to its decision not to mention the place of business of the counter-guarantor but to retain a reference to the confirmer, and referred to the reasons for that decision.

25. **Ms. ASTOLA** (Finland) said that the amendment proposed by the observer for Switzerland seemed to say more clearly the same as the existing text. It might be the intention of the amendment to state that parties could not invent places of business, which would be a good point, but the existing English text might allow that interpretation. In general, she supported the proposed amendment.

26. **Ms. CZERWENKA** (Germany) said she was not sure what change was introduced by the proposal. Paragraph (2) of the article provided that the criterion of internationality would be that the undertaking had listed different places of business, but there was no other objective criterion. She asked whether it was the concern of the drafters of the amendment to take into account what would happen if the place of business did not exist in reality, though the proposal did not explicitly address that question.

27. What was needed was a definition of internationality based on very simple criteria to make it possible to know when an instrument was international and would be covered by the Convention.

28. She thought that an amendment was not justified and preferred retention of the existing wording.

29. **Mr. MARKUS** (Observer for Switzerland) explained that the very slight change in the order of the wording of paragraph 1 was intended merely to clarify that the text referred to the objectively existing "places of business" of the persons concerned, which might not be obvious from the phrase "as specified in the undertaking".

30. To some extent, he agreed with the remarks made by the representative of Finland but was not sure that "as specified in the undertaking" could be construed in the way the Finnish delegation had suggested.

31. **Mr. CHOUKRI SBAI** (Observer for Morocco) asked whether it was obligatory to state the place of business or residence in the undertaking and whether there would be a penalty for failing to do so. If it was conceivable that neither place was specified, he suggested that the beginning of the paragraph be amended to read: "An undertaking is international if the places of business of two of the following persons are in different States ...". It would then be necessary to ascertain the real place of business.

32. **Mr. HERRMANN** (Secretary of the Commission) said that the wording of paragraph (1) proposed by the representatives for Sweden and Switzerland somewhat resembled that used in the United Nations Sales Convention (1980), which referred to the real place of business. In contrast, a more formalistic approach had been taken in the UNCITRAL Bills and Notes Convention (1988), which referred to the place as specified in the instrument. The proposed amendment lay somewhere between the two and was therefore, in his opinion, inoperable. The scope of application would be determined in two steps, first by inquiring about the real places of business and then by ascertaining whether they corresponded to the places specified in the undertaking. He therefore felt that it would be preferable to leave the paragraph as it stood.

33. **Mr. BYRNE** (United States of America) said that the Working Group had decided, in the interest of commercial certainty, that it ought to be possible to rely on the face of the instrument. The original wording of the paragraph reflected that requirement.

34. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) took it that the prevailing view was that the existing structure of the paragraph be maintained.

35. **Mr. BYRNE** (United States of America) said that the word "confirmer" had been inserted in the list referring to "any two of the following persons" because some delegations thought that otherwise, if the guarantor/issuer was also the confirmer and the two were in different countries, the Convention would not apply. Since there must be more than one category, it would be necessary to insert a reference to such persons as the transferee/second beneficiary, the confirmer and also, in his view, the counter-guarantor.

36. **Mr. HERRMANN** (Secretary of the Commission) said that two separate issues had been raised. One concerned the time of determination of internationality and the other, raised earlier by the representative of the United Kingdom, concerned the interplay between articles 4 and 6. The former raised a difficult policy issue, namely, whether account should be taken of changes in individual categories, for example, where one person moved outside a given jurisdiction. Should a legal regime apply for some time prior to a change in the beneficiary or before assignment of proceeds? The important question of the new beneficiary or transferee should be discussed separately.

37. On the second issue, an undertaking was considered to be international if the confirmer alone were in a different State from the other parties, but that did not apply in the case of a counter-guarantor. There was possibly a slight problem in that connection in the interplay between the definitions in articles 4 and 6. The

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statement in article 6 that "guarantor/issuer" included "counter-guarantor" and "confirmer", could not be interpreted as meaning, for the purposes of article 4, that each term subsumed the other two. It was therefore necessary to insert the term "confirmer" in article 4.

38. **Mr. FAYERS** (United Kingdom) suggested that article 6 (b) should be reworded to read: "guarantor/issuer, otherwise than in paragraph (1) of article 4, includes 'counter-guarantor' and 'confirmer'".

39. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) took it that there was insufficient support for the inclusion of "transferee" in the list of persons in paragraph 1 of Article 4. He asked whether there was any support for including the "assignee of proceeds".

40. **Ms. FENG Aimin** (China) said that rule 49 of the Uniform Customs and Practice for Documentary Credits (UCP) clearly stated that the assignee's role related to the transfer of proceeds and not to the transfer of rights. The assignee of proceeds should therefore not be included in the list.

41. **Mr. KOZOLCHYK** (United States of America) said that, although the assignee was not entitled to draw, the UCP rules stated that the rights of the assignee of proceeds were a matter for the law of individual countries. As the purpose of the Convention was to provide a measure of international uniformity and as the assignee of proceeds was mentioned in article 10, it was felt that it should also be included in article 4.

42. The Convention was likely to be particularly useful in dealing with both the transferee and assignee categories in order to ensure greater uniformity where there was a conflict between the laws of different countries. It would not make sense to omit categories because of a misunderstanding of the application of the rules and assignments.

43. **Ms. FENG Aimin** (China) said that if the transferee, as second beneficiary, were to be omitted, the assignee should also be omitted.

44. **Mr. EDWARDS** (Australia) said that it would be entirely unacceptable if the contractual basis of a transaction that was not initially international were changed *ex post facto*, merely because the assignee provided an international character.

45. **Mr. FAYERS** (United Kingdom) said that he shared the doubts of the representatives of China and Australia. He had great difficulty in understanding the practical implications of a provision that allowed an instrument to start life in one category and suddenly change to another.

46. He agreed that the assignee of proceeds should be omitted from the list.

47. **Ms. CZERWENKA** (Germany) did not seriously object to the inclusion of the transferee in the list of persons in paragraph (1) of article 4. Where an undertaking was transferable, it would probably be necessary to state in the undertaking itself that an international element might arise, as a result of, say, the nomination of a transferee in a different State.

48. **Mr. KOZOLCHYK** (United States of America) said that if the internationality of a beneficiary in a transferable stand-by letter of credit were accepted, there was every reason to accept the internationality of the transferee or second beneficiary.

49. The potential of the type of stand-by letter of credit known as "direct pay" for generating an enormous number of assignments had been one of the reasons for including provisions on the assignment of proceeds in the Convention. It was a type of financial obligation payable directly by the principal obligor on presentation of documents and was likely to be used extensively in the international money market. The resultant stream of payment might become effective anywhere in the world within seconds. People therefore needed to be assured that payment of the assignee was guaranteed by a legal regime. It was furthermore implicit in any stand-by letter of credit that the instrument was assignable from the moment of issue.

50. **Ms. ASTOLA** (Finland) asked whether the place of business of the assignees in question would in that case be mentioned in the undertaking.

51. **Mr. BYRNE** (United States of America) said that in the course of the transfer of a letter of credit, it was typical banking practice that a new letter of credit was issued to a second beneficiary, constituting in effect a virtually new undertaking. His delegation was not proposing that the first undertaking should retroactively be made international. But, if the second letter of credit, which might either supersede the original or become part of it, were on its face international, it would fall within the scope of the Convention. Similarly, if the document consummating an assignment were on its face international, the assignment and associated rights would also be international and come within the scope of the Convention.

52. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that there was insufficient support for the inclusion of "assignee" in the list of persons in paragraph (1) of article 4 and for the inclusion of "counter-guarantor" in the list. Lastly, he noted that there was insufficient support for the deletion of "confirmer" from the list.

The meeting was suspended at 3.35 p.m. and resumed at 4 p.m.

Article 5 (A/CN.9/408, annex)

53. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that there were no comments on article 5.

Article 6 (A/CN.9/408, annex)

54. **Ms. CZERWENKA** (Germany) said that the phrase "upon simple demand or upon presentation of other documents" in subparagraph (c) might have to be revised in the light of whatever decision was taken on the same phrase in article 2 (1).

55. In subparagraph (f), she suggested that the definition should read "'confirmer' means the person issuing a confirmation", in order to link it more clearly to the definition of "confirmation" in subparagraph (e).

56. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that those two points would be referred to the drafting group.

Article 7 (A/CN.9/408, annex)

57. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), introducing the article, said that paragraph (1) was concerned with when and where an undertaking was issued, paragraph (2) with the form in which it should be issued, paragraph (3) with the point of time at which a demand for payment could be made and paragraph (4) with the question of revocability.

58. **Mr. AL-NASSER** (Saudi Arabia) proposed that the closing phrase of paragraph (1) should be amended to read "leaves the sphere of control of the guarantor/issuer to be transferred to the beneficiary". Without such clarification, the undertaking might be regarded as having been issued even if it had left the sphere of control of the guarantor through theft.

59. **Mr. SHISHIDO** (Japan) asked whether paragraphs (1) and (2) were mandatory provisions, with the result that the parties could not agree on a different time of issuance and could not issue purely oral undertakings.

60. **Mr. HERRMANN** (Secretary of the Commission) said that, although both paragraphs (1) and (2) were strictly speaking mandatory, that was not really the point. Paragraph (1) was a definition of the term "issuance"; it was not concerned with the time of effectiveness, which was dealt with in paragraph (3). Paragraph (2) was intended to exclude purely oral undertakings, as had been agreed. It was left to the parties to stipulate a stricter form of undertaking if they wished.

61. **Mr. KOZOLCHYK** (United States of America) said that, when read in conjunction with paragraph (4), paragraph (1) amounted to more than just a definition. It established a rule as to the time when the undertaking became effective. It was not enough for two of the parties to reach agreement on the matter; all parties involved in the international network of correspondent banking relationships needed to know exactly when liability was incurred, particularly in view of the growing use of electronic communications.

62. **Mr. LAMBERTZ** (Observer for Sweden), noting that there had been some uncertainty about the precise meaning of "leaves the sphere of control of the guarantor/issuer", gave a hypothetical example. Belgium and Germany were assumed to be Contracting States. A Belgian bank having its only office in Brussels issued a demand guarantee through a German bank in Frankfurt, which was not a branch of the Belgian bank. The Belgian bank sent the documents to the German bank on 1 February, telling it to issue the guarantee on 1 March unless the mandate was withdrawn before that date. The mandate was not withdrawn, and the guarantee was issued in Frankfurt on 1 March, leaving the Belgian bank's sphere of control at that time. As he understood it, that case would not be covered by the Convention, because under article 1 the Convention applied if the place of business of the bank at which the undertaking was issued was in a Contracting State. In his hypothetical example, the Belgian bank had no place of business at which the undertaking was issued.

63. **Mr. FAYERS** (United Kingdom) said that he did not understand where, in the Swedish representative's hypothetical example, there was a gap in the coverage of the Convention. It seemed to him that the guarantee would have been issued by the German bank on 1 March. What was the relationship between the Belgian bank and the German bank?

64. **Mr. LAMBERTZ** (Observer for Sweden) said that the German bank was only the advising bank or agent, not the issuing bank.

65. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that if the German bank was merely an agent, and hence merely an extension of the Belgian bank, the answer to the question regarding the time of issuance might be that the undertaking was not issued until such time as the agent released it. The place of issuance might, however, be Brussels, not Frankfurt.

66. Referring to the problem of theft, he noted that the Saudi Arabian representative's concern was that the undertaking should leave the sphere of control of the issuer as a result of a voluntary act on the issuer's part. That concern was not, however, to be met by saying that it left the issuer's sphere of control for transfer to the beneficiary, because it might, before it reached the beneficiary, pass through the hands of an advising bank, a confirming bank, an agent, etc. The choice that had been made was that it would then for the purposes of the Convention be regarded as having been issued.

67. **Mr. AL-NASSER** (Saudi Arabia) suggested that the point might be covered if the text read "issuance of an undertaking occurs when and where the guarantor/issuer sends the undertaking".

68. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the word "send" was not clear, either. In the Swedish representative's example, was the instrument sent when it went from Brussels to Frankfurt, or only when it left Frankfurt? The term "sphere of control" had been preferred by the Working Group to "sphere of operation" on the understanding that an undertaking would leave the issuer's sphere of control only as the result of a voluntary act. If it were removed through an illicit act, it would not be regarded as having left its sphere of control.

69. **Mr. ILLESCAS** (Spain) said that a problem would arise only if the undertaking were presented for payment. According to article 2, the undertaking was a commitment to pay to the beneficiary. Hence the situation raised by the Saudi Arabian representative could come about only if the instrument were stolen by or on behalf of the beneficiary. If the issuer had not authorized the circulation of the instrument, the beneficiary would be acting fraudulently in presenting it for payment, and the situation would be covered by article 19, no payment being due in the circumstances. The wording used in article 7 thus seemed to him to offer adequate safeguards.

70. **Ms. FENG Aimin** (China) agreed with the Spanish representative. Under article 4, moreover, the issuer and the beneficiary would probably not be in the same place, so that the likelihood of theft would be small. In any case, under article 7, the bank could simply revoke a stolen guarantee and issue a new one.

71. On the question of the hypothetical example given by the Swedish representative, she agreed with the United Kingdom representative that it was necessary to establish the relationship between the banks. It seemed to her that, after the issuer issued the guarantee, the other party was simply in an advising position, so that no problem could arise.

72. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that it was not being suggested that issuance could occur involuntarily. Rather, there was concern about the wording and its possible interpretation. However, he took it that the Commission agreed as to what was meant by "issuance" and that the current draft of article 7 was acceptable.

Article 8 (A/CN.9/408, annex)

73. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) pointed out that in the current and subsequent articles, references to paragraph (1) of article 7 should be read as references to paragraph (2) of article (7). He invited the Commission to comment on article 8.

74. **Ms. CZERWENKA** (Germany) said that, for the sake of consistency, the authorization of an amendment by the beneficiary referred to in paragraph (2) (a) should be in the form stipulated in article 7 (2) in the same way as the notice of acceptance of an amendment by the beneficiary.

75. The question had been raised by the banking community in her country whether paragraph (2) related to both revocable and irrevocable undertakings. However, it seemed clear that the provisions covered only irrevocable undertakings.

76. **Ms. FENG Aimin** (China) said that oral amendments should not be permitted, though the article made no provision on that point. On the other hand, the Chinese version made it clear that issuance must be made in tangible form. She asked for clarification of the English version with regard to oral amendments.

77. **Mr. KOZOLCHYK** (United States of America) said that, under paragraph (2) (b) of article 8, the beneficiary's consent was not required if an amendment consisted "solely of an extension of the validity period of the undertaking", on the assumption that such an extension would invariably be in the interest of the beneficiary. However, that might not always be the case.

78. In stand-by letter of credit practice, a confirming bank might not have agreed to an extension, but the provision as worded did not make it clear whether or not a confirming bank would be bound by the extension. Also, a beneficiary might not want to have an extended credit or an extended bank guarantee.

79. **Mr. EDWARDS** (Australia) said that the passage at the end of paragraph (2), beginning with the words, "if any amendment does not fall ...", should perhaps be made into a separate paragraph.

80. Although issuance had been appropriately defined in paragraph (1) of article 7 with regard to an undertaking, it did not seem to have been defined in the context of amendments.

81. He agreed with the representative of the United States on the question of the beneficiary's agreement under paragraph (2) (b).

82. **Mr. ILLESCAS** (Spain) said that subparagraph (a) as drafted raised many questions. The condition that an amendment should be effective if previously authorized by the beneficiary should be changed to stipulate a previous proposal, suggestion or request by the beneficiary. The mechanism for authorization by the interested parties should also cover conditions for extension of validity.

The meeting rose at 5.05 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 551st MEETING

Held at the Vienna International Centre, Vienna,
on Thursday, 4 May 1995, at 9.30 a.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Draft Convention on Independent Guarantees and Stand-by Letters of Credit (*continued*)

Article 8 (*continued*)

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Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

V.95 58987 (E) (a:\1995\uncitral 1)

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The meeting was called to order at 9.30 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 8 (*continued*) (A/CN.9/408, annex)

1. **Mr. EDWARDS** (Australia) wondered whether the "validity period" (article 8), mentioned in paragraph (2) (b), ought not to be defined, in view of the wording of article 7 and the fact that the term also appeared in articles 11 and 12.

2. **Mr. CHOUKRI SBAI** (Observer for Morocco), supporting the opinion expressed by the representative of Australia, suggested the addition, in article 8, of wording along the lines of "issuance of an amendment shall be in conformity with the terms of paragraph (1) of article 7".

3. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that, if it was feared that there might be confusion between the ideas of revocation and amendment, a phrase such as "unless stipulated to be revocable" could be inserted in paragraph (2).

4. **Mr. HERRMANN** (Secretary of the Commission) thought that there was a wider issue and referred to the paper submitted by the International Chamber of Commerce, which mentioned the rule set out in article 8 of the Uniform Customs and Practice for Documentary Credits (UCP). The position was clear if a stand-by letter of credit incorporated reference to UCP. He wondered whether the Commission wished to include a similar rule, in the interest of consistency.

5. **Ms. FENG Aimin** (China) pointed out that, pursuant to UCP and the Uniform Rules for Demand Guarantees (URDG), revocability was determined at the time of issuance.

6. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that, since instruments were basically irrevocable, revocability had to be stipulated. He asked whether the Commission really wished to insert specific reference to revocability in an article on amendment, in respect of instruments not subject to UCP or URDG. In the absence of any comment, he would assume that the current text was acceptable.

7. With regard to paragraph (2) (a), he asked whether the Commission wished to establish a required form for previous authorization by the beneficiary.

8. **Mr. CHOUKRI SBAI** (Observer for Morocco) supported the current wording and stressed the advisability of avoiding too many formal requirements.

9. **Mr. BYRNE** (United States of America) said that his delegation did not want to insert a formality requirement in paragraph (2) (a). The provision was unnecessary because paragraph (1) of article 8 made appropriate reference to paragraph (1) of article 7.

10. **Ms. FENG Aimin** (China) supported the view expressed by the United States representative. Paragraph (1) of article 7 was binding and there was therefore no need to make any stipulation about previous authorization in article 8.

11. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he understood the representatives of China and the United States to have said that there was no need for subparagraph (a) and that there should not be two regimes, one in which the amendment became effective upon issuance and one in which it became effective when a notice of acceptance was given. He asked whether the Commission wished to maintain the two rules. Paragraph (2) (b) might simply be deleted, which would mean that the undertaking could be amended only when the guarantor/issuer received a notice of acceptance.

12. **Mr. ILLESCAS** (Spain) said it would be clearer to delete paragraph (2) (b), as that would harmonize the different regimes for amendments and dispel any doubts as to when notification of an amendment was needed.

13. **Mr. SHISHIDO** (Japan) said he would accept either option, but it would be simpler and better to follow the proposals made by the representatives of China and the United States.

14. **Mr. ADENSAMER** (Austria) said that rules should not be made simply from an academic point of view. It was not rare in practice to have extensions of the validity period of an undertaking. The present text should be retained, as it had been dictated by the needs of practice.

15. **Mr. VASSEUR** (Observer for Monaco) said that no amendment could be extended without its being accepted by the beneficiary, but that if it was the beneficiary who had requested the amendment, then his acceptance was not necessary. He would prefer to delete subparagraph (b) and retain subparagraph (a).

16. **Mr. STOUFFLET** (France) said that he could accept the article as drafted but thought that subparagraph (a) should be clarified. He wondered whether the difficulty was due to the use of the word "authorized" and whether the word "requested" might not be clearer.

17. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said he supported the deletion of subparagraph (b).

18. **Ms. BAZAROVA** (Russian Federation) said she would like to keep the text as it was, since it was based on practice. She shared the misgivings of the representative of France and felt that it would be better to replace the word "authorized" by "requested".

19. **Mr. OGARRIO** (Mexico) agreed with the proposals to replace "authorized" by "requested" and to delete subparagraph (b).

20. **Mr. MAHASARANOND** (Thailand) said he supported the present text.

21. **Mr. KOZOLCHYK** (United States of America) said that to eliminate subparagraph (b) would not be merely to express an academic point of view, but to conform with practice. If it were kept, it would not only be in contradiction with practice, but also contrary to UCP.

22. **Mr. CHOUKRI SBAI** (Observer for Morocco) said the phrase "unless otherwise stipulated" opened the door to freedom of contracting. That was in the interest of the beneficiary, and accordingly, it would be useful to retain the text.

23. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he took it that the Commission wished to maintain the dual approach reflected in the two subparagraphs, but that the word "authorized" could be replaced by the phrase "previously requested or otherwise consented to". It appeared that work was needed by the drafting group to clarify the idea that "unless otherwise stipulated" referred to the whole of paragraph (2).

24. **Mr. KOZOLCHYK** (United States of America) said that with regard to practice in stand-by letters of credit, paragraph (2) (a) meant that by formal means in the text of a letter of credit or amendment, the amount available could be increased or decreased on an automatic basis. A difficulty was raised by the word "requested", which would present the banks with a different issue, from an operational viewpoint. The form of request could vary substantially, depending on whether it came from the beneficiary or the issuer, which would invite confusion or litigation. The word "authorized" had a more serious connotation than the word "requested", and the two should not be used together.

25. **Ms. FENG Aimin** (China) agreed with the representative of the United States that the article had worrisome aspects. One such aspect was the way it differed from the terms of article 2, paragraph (2) (b): "at the request or on the instruction of the customer ('principal/applicant') of the guarantor/issuer". That might cause some confusion.

26. **Mr. EDWARDS** (Australia) said he shared the concern raised by the representative of the United States. A dispute could arise as to the terms of consent.

27. **Mr. BOSSA** (Uganda) said the use of the word "authorized" or "requested" would depend on where the amendment originated. If it was initiated by the applicant, it would be authorized or consented to by the beneficiary. If, however, it was initiated by the beneficiary, then he would have requested it. To cover the two situations, the text could read "The amendment had been previously authorized or requested by the beneficiary".

28. **Mr. KOZOLCHYK** (United States of America) said his delegation could not accept subparagraph (b) as it applied to stand-by letters of credit practice. The United States banking industry had felt that if there was a rule that the beneficiary need not be consulted, it would have to oppose the adoption of the Convention. The only alternative would be to reserve a rule for the stand-by practice, but the procedure of having such special rules had so far been avoided.

29. **Mr. FAYERS** (United Kingdom) said that while the issue was not important in guarantee practice, it evidently was in regard to stand-by letters of credit. The provision introduced a new operational rule, replete with difficulties, and he therefore agreed with the representative of the United States.

30. **Mr. LAMBERTZ** (Observer for Sweden) said in fact the question was a minor one. The only issue was when an amendment became effective. If the amendment were of the kind referred to in subparagraph (b), consisting solely of an extension of the validity period of the undertaking, both parties would normally consider that it had been made and there would be no need for acceptance by the beneficiary. According to the rule, however, it would not have been made. It would therefore cause problems to eliminate subparagraph (b). However, he wondered whether the drafting had to be so precise as to the time when the amendment became effective. A compromise might be to state "unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and beneficiary, an undertaking is amended when consented to by the beneficiary".

31. **Mr. OGARRIO** (Mexico) said that paragraph (2) (b) had been introduced as an exception to the general principle whereby the consent of the beneficiary was necessary for an amendment, on the assumption that the extension of the validity period of the undertaking would always be to the advantage of the beneficiary. It had, however, been pointed out that in some cases an extension would not be to his advantage, particularly in the case of commercial letters of credit. He therefore supported the deletion of paragraph (2) (b).

The meeting was suspended at 11 a.m. and resumed at 11.20 a.m.

32. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that as his suggested use of the word "requested" did not appear to solve the problem, it would perhaps be better to stick to "authorized", as being closer to what had been intended. On the more substantive point of whether to keep or to delete subparagraph (b), there appeared to be two schools of thought. It was, in his view, necessary to consider whether there did indeed exist cases that would make the rule a bad one and, conversely, whether there existed other cases that made it essential. The wording "unless otherwise stipulated in the undertaking" implied the possibility of supplementing or replacing the present rule by some other provision such as a rule based on UCP or URDG. On reflection, however, and taking into account the practical point of view, he had come to the conclusion that it might be preferable to delete paragraph (2) (b). The exercise of drafting a new convention that applied a unified system of rules for instruments that were seen by some as being different or that did indeed reflect different practices had led the Working Group to seek uniform rules that respected such differences in practices while attempting to bridge them. However, it had emerged that for a significant segment of practices in relation to stand-by letters of credit, paragraph (2) (b) would raise problems. Though others considered that paragraph to be useful, he felt that its deletion would have a lesser impact on practices than its retention. In his view, a text without paragraph (2) (b) was more likely to achieve consensus.

33. **Ms. FENG Aimin** (China) said that she was not opposed to the deletion of paragraph (2) (b), but felt that a number of issues needed to be considered. One of them concerned the position of the confirmer, who was often involved in the amendment of an undertaking. The majority of banks followed ICC rules, and too much emphasis on amendment of the relationship between the issuer and the beneficiary would create problems. Indeed, consideration should be given to deleting the entire paragraph (2) of article 8. There also appeared to be a contradiction between article 8 and article 2 (2), which concerned the relationship between the principal/applicant and the guarantor/issuer. In banking practice, banks followed the instructions of the applicant. If the applicant wanted an amendment to be issued, whether or not the beneficiary's consent had been obtained beforehand, the bank must respect that request. There was also a conflict with UCP and URDG, which was likely to raise many problems of a practical nature. As the article appeared to contradict actual practice in the banking world, she did not think it advisable to add extra rules. In her view, article 8 (2) went too far and would merely complicate current banking practices. On the other hand, its deletion would not give rise to any problems. In short, paragraphs (1) and (3) were sufficient on their own. There was no need for paragraph (2).

34. **Ms. ASTOLA** (Finland) said she was not entirely against the deletion of paragraph (2) (b) in its present form. In most cases it was the beneficiary who asked for an extension, a case covered by subparagraph (a). But sometimes the extension was initiated by the guarantor or principal. There again there was no problem if the beneficiary had previously accepted the extension or if such an extension had been provided for in the guarantee. But there might be a problem if nothing had been said about such an extension which might then, in some cases, be unfair to the beneficiary. She therefore suggested adding the words "and

(*Ms. Astola, Finland*)

consented to by the beneficiary" in paragraph (2) (b). Such consent would not necessarily have to be given beforehand.

35. **Mr. LAMBERTZ** (Observer for Sweden) said he agreed in substance with what the representative of Finland had said. If paragraph (2) (b) were to be deleted, it would be necessary to meet the concerns of those who saw such a deletion as creating a problem. It might be possible to add in subparagraph (a), after the word "authorized" the words "or is otherwise consented to by the beneficiary". That would open the possibility, in the event of an argument about whether an amendment was effective or not when the validity period had been extended, to regard it as the kind of amendment for which the non-objection of a beneficiary implied his consent.

36. **Ms. CZERWENKA** (Germany) said that, having heard the arguments, especially those of the representative of Mexico, her delegation could now agree to delete paragraph (2) (b). In practice most cases would be covered by paragraph (2) (a).

37. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), after inviting comment, noted that there was no support for the Chinese suggestion to delete paragraph (2) altogether.

38. After inviting comment, he noted that there was some support for the Finnish suggestion to retain paragraph (2) (b) and incorporate into it the notion of consent by the beneficiary.

39. After inviting comment, he noted that there was support for the Swedish proposal to delete paragraph (2) (b) and reword paragraph (2) (a) to speak of the amendment having previously been authorized or otherwise consented to by the beneficiary. He asked whether the intent was that the consent "otherwise given" would be given after the issuance but be retroactive to it.

40. **Mr. LAMBERTZ** (Observer for Sweden) said that his intention was that the amendment should be effective on issuance unless opposed. He was not asking for the consent to be active. It would be non-opposition that was retroactive to the time of issuance.

41. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) wondered whether the proposal would not create more difficulties than it would solve. In his view, it did not make it clear when an amendment was effective and in what circumstances.

42. **Mr. HERRMANN** (Secretary of the Commission) considered that it would be a contradiction to state in the first rule that the time of receipt of the notice of acceptance was the effective one, and then in the second rule to include a possibly later consent. If that possibility was ruled out, in his view the only remaining question was whether, when the original validity period had expired and the validity had been extended, an amendment should be effective at the time of the consent or retroactively at the time of issuance of the amendment. That question might almost be academic, but the latter alternative might create legal uncertainty with respect to the time between issuance and consent. Once the Commission had dealt with that question, it would be easy to draft the rule. He suggested that a single rule be drafted without discussing where to put it, which was merely a matter of editing.

43. **Ms. CZERWENKA** (Germany) said that she was against any change that would give acceptance to a retroactive effect.

44. **Ms. BAZAROVA** (Russian Federation) said her delegation would prefer a provision covering not subsequent consent to an amendment but the absence of an objection. If that was too difficult to achieve, she would endorse the Chinese proposal to delete the provision altogether, so that no misunderstanding would be possible.

45. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that the Working Group had discussed a "no objection" rule, to the effect that if there was no reaction from the beneficiary for 10 days the instrument was automatically amended. He therefore wondered if the Commission was not going over old ground. He cautioned it not to lose sight of the interests both of the issuer, who wished to know whether and how far he was bound, and of the beneficiary, who wished to know the nature of his rights and whether those rights were at the mercy of the issuer.

46. **Ms. FENG Aimin** (China) said that her delegation might consider the Swedish proposal, but had a problem in connection with the relationship between issuer and beneficiary. The Commission should take account of article 9 (c) (i) of the UCP rules, which stated that if another bank was authorized or requested by the issuing bank to add its confirmation to a credit, but was not prepared to do so, it must so inform the issuing bank without delay. That article showed that the rights of the guarantor in the operations took precedence over those of the beneficiary, whereas the Commission's approach was the contrary one.

47. **Mr. EDWARDS** (Australia) suggested that delegations should be given an opportunity to take another look at the whole range of options.

48. **Mr. SHISHIDO** (Japan) suggested that the Commission should revert to the French proposal to use the word "requested" instead of "authorized", since there was no need to take account of cases where an amendment was initiated by the issuer, but only of those where it was initiated by the beneficiary.

49. **Mr. KOZOLCHYK** (United States of America) supported the suggestion of the Australian representative.

50. He had been involved in writing the UCP provisions and knew that the question of amendments was a very complicated one. Following a long discussion on amendment practices, it had been found that the commercial letter of credit practice was that the consent of the beneficiary was needed, implying that until that consent was given, the credit should remain valid as originally issued. That principle was needed because otherwise there would be great uncertainty for the beneficiary as well as for the confirming and intermediary banks.

51. Once the principle of the need for consent by the beneficiary was established, the question was how the beneficiary should express that consent. The UCP had started by saying that if within seven days nothing was heard, consent should be deemed to have been given. It had then encountered arguments to the effect that there were very few national laws in which the silence of a party was deemed to be binding as an expression of positive consent.

(*Mr. Kozolchyk, United States of America*)

52. He suggested that the Commission should confine itself to laying down principles and not try to prescribe methods in great detail, in view of the widely differing practices in the banking industry. There did seem to be a consensus that the consent of the beneficiary was needed for an amendment, and the Commission should now establish whether that consent had to be express or implied.

The meeting rose at 12.30 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 552nd MEETING

Held at the Vienna International Centre, Vienna,
on Thursday, 4 May 1995, at 2 p.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

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Distr.: 14 November 1995

The meeting was called to order at 2.10 p.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408 and A/CN.9/411)

Article 8 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) restated the question under discussion and asked the Commission to consider an approach whereby the article would state that an amendment had to be in a form stipulated, that the consent of the beneficiary was required and that the amendment would have no effect on the rights and obligations of the principal/applicant or of a confirmer unless they had given their consent. The article should also leave open the possibility of providing otherwise.

2. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that a similar proposal had been before the Committee, namely, to retain the existing text and leave the initiative to the guarantor but to add a passage to state that the amendment would not be considered final unless the beneficiary consented. In that way, the guarantor would have the initiative but that initiative would not be accepted or final without the consent of the beneficiary.

3. **Ms. CZERWENKA** (Germany) believed that a mere statement that consent was required would be a backward step. If the question of when the amendment became effective were not regulated in the Convention, it would be subject to national law, so that there would be no uniformity. She believed that the Committee had been very close to agreement on the question of the time of effectiveness and would regret it if the question were left open.

4. **Mr. LAMBERTZ** (Observer for Sweden) supported the proposal made by the Chairman of the Committee of the Whole. He was not convinced that uniformity was necessary, a point that had been made earlier by a number of delegations.

5. The question of the time of effectiveness had been discussed at length and it was difficult to find a better solution than that proposed. States might wish to adopt more precise rules in their national laws, though he was not convinced that his country would wish to do so.

6. **Mr. FAYERS** (United Kingdom) said that he shared the Swedish view though he rather agreed with the representative of Germany that the statement was merely one of principle and that it would not achieve much progress towards uniformity, though uniformity might not be necessary in practice. The Secretary had cogently put the question whether retroactive provisions were necessary. The Commission had been close to accepting article 8 (2) with the deletion of subparagraph (b). He would be prepared to support that proposal or even the inclusion of both subparagraphs (a) and (b) if it could be shown to be necessary that the matter should be dealt with in the Convention rather then left to the market.

7. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that no delegation seemed to favour a reference to retroactive effect in the article. It would therefore seem that on balance a text on the lines of paragraph (2), without subparagraph (b), would suffice. That would leave the provision in line with UCP rules.

8. *It was so agreed.*

Article 9 (A/CN.9/408, annex)

9. **Mr. EDWARDS** (Australia) proposed that the words "if so, and" in paragraph (1) be deleted. That would make the wording simpler and more consistent with the reference to the same concept at the end of paragraph (2).

10. **Mr. FAYERS** (United Kingdom) said he thought it had been agreed that the passage in paragraph (1) should read "if authorized in the undertaking and only to the extent and in the manner set out therein". Perhaps the Secretary could clarify the question.

11. **Mr. HERRMANN** (Secretary of the Commission) explained that paragraph (1) was intended as a provision limiting the possibility of a transfer, to cover those cases in which a transfer was authorized and those in which it was not, while paragraph (2) covered cases in which there was an authorization of transfer — a transferable instrument — so that "only if" would be illogical there. The form of words suggested by the United Kingdom seemed to be preferable.

12. **Ms. CZERWENKA** (Germany) said that the question was not the extent to which the beneficiary's right to demand payment could be transferred but whether that right could be transferred at all. She would support the text as it stood, subject to possible drafting improvements.

13. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) asked if he could take it that there was agreement in principle that transferability must be authorized in the undertaking and that the extent and manner of transfer were secondary matters. On that assumption, the text could be passed to the drafting group.

14. **Mr. VASSEUR** (Observer for Monaco) said he could understand that the transferability of an undertaking required to be authorized. However, partial transfers existed and he asked for an explanation of the phrase "in the manner authorized".

15. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that the basis was article 49 (c) of the ICC Customs and Practice.

16. **Mr. KOZOLCHYK** (United States of America) noted that, in his summing up, the Chairman had mentioned the principle of the transferability of an undertaking and the question of its manner and extent. However, there seemed to have been no reference in the Chairman's remarks to the consent of the issuer.

17. In reply to the question raised by the observer for Monaco, he explained that the term "extent" referred to whether transferability was partial or not, and the term "manner" referred to the mechanism used, such as the issuance of another credit.

18. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that he had been referring only to paragraph (1). He had not suggested deletion of paragraph (2), which referred to the question of consent.

19. **Mr. LAMBERTZ** (Observer for Sweden) said he had been asked by Professor Hâstad, of Sweden, who had studied the draft, to raise the question whether, in the event of insolvency of the beneficiary, the undertaking as an asset could be divided up among the creditors of the beneficiary if it were not transferable.

20. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that the principle embodied in paragraph 9 (1) had been agreed upon and that the text would be passed to the drafting group. The question raised by Monaco had been answered. He appreciated the point made by the observer for Sweden regarding insolvency but was not convinced that the law on insolvency was uniform world-wide and doubted whether that question could be handled in the context of the Convention. In any case, the Commission would be discussing insolvency later in the current session. Since there were no comments on the question of insolvency he assumed that the Commission wished to approve article 9 as it stood.

21. *It was so agreed.*

Article 10 (A/CN.9/408, annex)

22. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) emphasized that the article referred to the assignment of proceeds and not to the assignment of an undertaking. As before, references in the text to paragraph 7 (1) should read 7 (2).

23. **Mr. FAYERS** (United Kingdom), referring to paragraph (1), asked what was the background of the provision that the agreement not to assign the proceeds of a guarantee need not be in the form stipulated in paragraph 7 (2), which presumably meant that an oral agreement would be possible. He doubted whether that would be the correct procedure.

24. The wording "if the guarantor/issuer or another person obliged to effect payment has received a notice of the beneficiary", in paragraph (2) confined the giving of notice to the beneficiary, who was the assignor. Under English law notice could also be given by the assignee, who was the main interested party in giving the notice. He asked the reasons for that restriction.

25. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) referred to the decision of the Working Group reflected in paragraph 32 of the main body of the document under discussion, namely, that it was not necessary to add additional references to a form requirement in paragraph (1) with respect to a waiver of the right to assign proceeds. That raised the question of whether the phrase "or elsewhere agreed by the guarantor/issuer" in paragraph (1) was appropriate. The Working Group had also affirmed that notice of assignment, in order to be reliable, needed to originate from the beneficiary, and that partial assignment was not precluded.

26. **Mr. KOZOLCHYK** (United States of America), replying to the question raised by the representative of the United Kingdom, said the reason why the beneficiary was the notifying party was that the assignment would not be effective unless there was compliance by the beneficiary with the terms of the bank guarantee or stand-by letter of credit.

27. **Ms. FENG Aimin** (China) said that the text of article 10 was acceptable to her delegation. With regard to the right of the beneficiary, the assignee had no right to know the source of the payment. Notice given by the beneficiary asking the bank to pay the money to the assignee was sufficient, as had just been explained by the United States representative.

28. **Mr. CHOUKRI SBAI** (Observer for Morocco) pointed out that it was a mandatory provision that notice be sent by the beneficiary, for a number of important reasons. Firstly, the parties to the undertaking numbered three — the guarantor, the principal/applicant and the beneficiary, and the assignee was not a party to the undertaking. The second reason was that the risk of theft or loss of the undertaking arose, and greater safety would be ensured by providing that only the beneficiary could send the notice. The third reason was that an irrevocable assignment could be carried out only by the beneficiary. His delegation considered that the line taken by the Working Group on the matter had been the right one.

29. **Mr. ILLESCAS** (Spain) said his delegation too could accept the formulation of article 10 proposed by the Working Group. There were sound arguments for restricting notice of assignment to the beneficiary since, in an international context, the assignee might be completely unknown to the guarantor/issuer, whereas the beneficiary would, at some point at least, be known.

30. The irrevocability of the assignment was a matter of great importance where the obligor's discharge from liability was concerned, and he suggested that attention should be drawn to that point by amending the title of the article to read "Irrevocable assignment of proceeds".

31. **Mr. EDWARDS** (Australia) said that the formulation "... has received a notice of the beneficiary" was misleading. He would prefer the expression "... a notice originating from the beneficiary", in line with the expression used by the Working Group in paragraph 32 of the main body of the document.

32. **Mr. HERRMANN** (Secretary of the Commission) said that the wording in paragraph (1) had been chosen by the Working Group, not by the Secretariat. He noted that in the area of receivables financing, on the question of assignment of claims, it was suggested that in order to be effective, such assignment could be made by notice of the assignor or with the authorization of the assignor from the assignee. Such a solution would be a possible way out of the dilemma. The wording "has received a notice of the beneficiary" might be meant to imply notice received not directly but through an intermediary. However, the expression "originating from" should be sufficient to meet the need for reliability and would be consistent with terms used earlier.

33. **Mr. FAYERS** (United Kingdom) said that, while he could accept the formulation "notice of the beneficiary", that had not been acceptable to some delegations, which had considered that notice should come from the assignor. The wording should make it clear that notice could be given by the beneficiary if that was indeed the intention, since the wording as it stood might be interpreted as not preventing notice being given by the assignee — which, as he understood it, had not been the intention of some members of the Working Group.

34. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the policy question was whether the notice must originate from the beneficiary or whether a broader provision should apply.

35. **Mr. BYRNE** (United States of America) agreed that it had been the Working Group's position that, because the species of undertaking embodied in a letter of credit or independent guarantee was a special obligation towards a named person, only the named beneficiary could make a drawing and make an enforceable, irrevocable assignment of proceeds. A notice originating from the assignee would in practice be ignored by a bank as lacking authority. The principle to be preserved was the entitlement or right of the beneficiary alone to be paid. That had been the Working Group's intention, and it should be reflected in the draft.

36. **Mr. KOZOLCHYK** (United States of America) said that confusion had arisen because the term "notice" covered two separate documents. The first was the beneficiary's irrevocable order to the bank to make payment, which could come only from the beneficiary, and the second was the confirmation sought from the bank by the assignee that he would receive payment.

37. **Mr. FAYERS** (United Kingdom) said that article 10 (2) dealt with the notice given to the bank as to who was to be paid; under English law that particular notice could be given by the assignee, who was in fact the party with the chief interest in giving such notice. His own position was that the provision should not be restricted to the assignor, but if it was the Commission's wish to make the provision more restrictive, and more in line with United States law on the matter, the wording should be clarified.

38. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) stressed that article 10 was not intended as a codification of the law on assignment of proceeds. Paragraph (1) covered the assignability of proceeds. Paragraph (2) dealt with the specific question of when the guarantor/issuer could consider that he had discharged his obligation under law. The question under discussion was whether notice on that point had to originate from the beneficiary alone.

39. **Ms. ASTOLA** (Finland) said that, as she saw it, the important issue was that the beneficiary should consent to the assignment. She had interpreted the expression "has received a notice of the beneficiary" to mean that notice could come from any person, given the consent of the beneficiary.

40. **Mr. BYRNE** (United States of America) said that his delegation's position on the matter was not influenced by United States law on assignments. However, United States law on assignments, though very similar to that of the United Kingdom, differed radically from the law governing the assignment of proceeds under letters of credit, which was mercantile law. The general principle of commercial law that everything could be made assignable did not obtain, because the person with whom the guarantor/issuer was dealing was usually a stranger, and thus the risk of paying the wrong person and having to make double payment would be borne either by the guarantor/issuer or in most cases by the applicant.

41. The banks had therefore instituted very careful procedures, which included three elements: first, a request on the part of the beneficiary for an assignment of proceeds, following which the bank would require the beneficiary to produce the original letter of credit and to state irrevocably to whom the payment was to be made. The second element might be, as pointed out by the United Kingdom representative, a further notice requesting acknowledgement. The third element, which was of most value to the assignee, was acknowledgement from the bank that it had recognized the assignment. The Commission was not trying to set up a universal scheme to regulate the assignment of proceeds, but was rather trying to clear up confusion regarding discharge of obligation under an international instrument, which would be of great use commercially throughout the world.

42. The critical principle that was addressed in paragraph (2) was that consent to the assignment must originate from the named beneficiary, since otherwise there would be risk of double payment, fraud or forgery.

43. **Ms. CZERWENKA** (Germany) said she had understood article 10 (2) as a very basic, uncontroversial rule, covering the issue of the conditions under which the guarantor/issuer could pay to the assignee and be discharged from liability. The Commission should not try to deal with other matters relating to assignment law in general. In her delegation's view the provision could be very restrictive, stating simply that the notice to the guarantor/issuer must stem from the beneficiary. The liability would then be discharged by payment to the person named. The question whether the guarantor/issuer could rely on any other notice that he might receive did not come within the scope of the Convention.

44. **Ms. FENG Aimin** (China) endorsed the views of the representatives of the United States and Germany.

45. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he believed it to be the prevailing view in the Commission that notice of assignment, to be acceptable, must be offered by the beneficiary. Accordingly, unless he heard otherwise, he would take it that the Commission wished the text of paragraph (2) to express that principle and that the text be referred to the drafting group on that understanding.

46. *It was so agreed.*

The meeting was suspended at 3.45 p.m. and resumed at 4.10 p.m.

47. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) reminded the Commission of the suggestion by Spain that the word "irrevocable" should be inserted before the word "assignment" in the title of article 10. The notion of irrevocability appeared in paragraph (2) but not in paragraph (1); moreover, in some countries, certain kinds of assignment were irrevocable whereas others were not, and also article 49 of the UCP rules did not speak of irrevocability in regard to assignments of the proceeds of documentary credits. He therefore asked the Commission to consider whether, in regard to the proceeds of instruments covered by the Convention, it intended article 10 to apply to irrevocable assignments alone.

48. **Mr. BYRNE** (United States of America) said he believed that the article should so apply. In any case, the proceeds of instruments covered by the Convention were contingent and consequently their assignment — in reality an irrevocable payment order — was of limited commercial value; if it was to be revocable as well, that value would become little more than illusory. He therefore supported the Spanish suggestion, as a means of drawing attention to the particular nature of the assignments contemplated in article 10.

49. **Ms. BAZAROVA** (Russian Federation) said that the inclusion of the word "irrevocable" in the title drew attention to an element that it was unnecessary to emphasize, but that her delegation would not oppose the change. Assignment of the proceeds under discussion was a straightforward matter: if the obligor was a bank, an instruction to it from the beneficiary to pay someone else would suffice.

50. **Ms. FENG Aimin** (China) agreed that it was unnecessary to stress the element of irrevocability. The title was adequate as it stood, and changing it would not alter the obligor's position. The important point was that article 10 should ensure that, if the beneficiary assigned the proceeds, his instructions would be carried out.

51. **Mr. ILLECAS** (Spain) said that article 49 of the UCP 500 rules was irrelevant to the Commission's consideration of the issue because it referred the effects of assignment to rules of national law. The Convention, on the other hand, established rules of universal application, and in the case of article 10 they were those applicable to the specific effects of the assignment. Under that article, if the guarantor made payment by means of an irrevocable assignment, it was discharged from its liability, something quite different from what was covered by article 49 of the UCP 500 rules.

52. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the Commission might intend paragraph (1) to mean that a beneficiary could make either an irrevocable or a revocable assignment, while paragraph (2) might be intended to specify what would happen if the beneficiary made an irrevocable assignment. That intention would be expressed by the present wording of paragraph (1), and therefore the title should not be changed. Although titles were not substantive law, the inclusion of "irrevocable" would imply that a similar qualification would also apply to paragraph (1). Unless he heard any objection, he would take it that the Commission wished the title to remain unchanged.

53. *It was so agreed.*

Article 11 (A/CN.9/408, annex)

54. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) reminded the Commission that references to "article 7 (1)" should be read as "article 7 (2)".

55. In considering article 11, it should be remembered that cessation of the right to demand payment did not necessarily occur at the same time as expiry of the validity period of the undertaking.

56. **Ms. ASTOLA** (Finland) pointed out that, under article 8 (1), an undertaking could be amended in a form other than that prescribed in article 7 (2). If the parties could amend an undertaking orally, they should be able to terminate it orally as well. She suggested that article 11 (1) be modified to permit that, leaving it to the relevant rules of evidence to determine whether or not termination had taken place.

57. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) pointed out that the Working Group, at its twenty-first session, had decided that purely oral termination should not be allowed (document A/CN.9/391, paragraph 77).

58. **Ms. CZERWENKA** (Germany) said that her delegation could agree that the wording of paragraph (1) (b) should be aligned with that of article 8 (1), so as to enable oral termination to take place where the undertaking so provided.

59. Paragraph 1 (c) raised the question of revolving guarantees. It stipulated that the right to demand payment under the undertaking ceased when the amount available had been paid, unless there was provision for automatic renewal. In her view that was illogical because, if there was automatic renewal, full payment could never be made. She therefore proposed deletion of the words "unless the undertaking provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the undertaking". In any case the matter of revolving credits should not be overemphasized.

60. **Mr. MARKUS** (Observer for Switzerland) said that criticism had been directed in his country to the contradictions inherent in the combined effect of paragraph (1) (a) and (b) and paragraph (2). He asked how article 11 would operate where an undertaking stipulated that it must be returned to the sender for cessation of effectiveness and the beneficiary sent the guarantor a statement of release pursuant to paragraph 1 (a). It would be anomalous if the beneficiary were still entitled to demand payment. The reasons for cessation in paragraph (1) and paragraph (2) were mutually exclusive and should constitute alternative and not cumulative reasons for cessation of the right to demand payment.

61. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) asked whether the "statement" referred to in paragraph (1) (a) could be an oral statement. Bearing in mind the use of the words "in any form" in article 7 (2), he believed that should be the case. If not, the term "statement" should be altered to "notice" or a similar word.

62. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) remarked that article 7 (2) excluded an oral statement. He agreed that "notice" might be a more appropriate word than "statement".

63. On a point of drafting, in paragraph (1) (a) the words "statement from the beneficiary" might be preferable to "statement of the beneficiary".

64. **Ms. FENG Aimin** (China) said that the Convention did not allow undertakings to be issued in oral form; consequently it should not allow statements of release from liability to be given in that form either.

65. Paragraph (1) (c) should be retained, because of the great use made by banks of revolving guarantees.

66. **Mr. EDWARDS** (Australia) said that he too recommended using the words "statement from the beneficiary".

67. **Ms. BAZAROVA** (Russian Federation) said that it would be logical to delete the whole of subparagraph (c), in the light of the explanation given by the representative of Germany. But if the idea was to delete only the last clause, beginning with "unless", and keep the first part of the subparagraph, she would have misgivings.

68. **Ms. CZERWENKA** (Germany) explained that her delegation's proposal was to delete the latter part of the subparagraph, beginning "unless". The key issue was whether the amount available under the undertaking had or had not been paid.

69. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said it was his understanding that the term "a statement ... of release" in article 11 (a) did not permit an oral statement. It might be possible to say "a release from liability from the beneficiary in a form referred to in paragraph (2) of article 7".

70. **Ms. ASTOLA** (Finland) said that her suggestion regarding oral termination related to subparagraph (b) and was intended to mean that the undertaking could be terminated orally if there was a stipulation to that effect in the undertaking itself.

71. **Ms. BAZAROVA** (Russian Federation) asked how in such cases there would be any proof of what had occurred. She thought it would probably be better to leave the subparagraph as it was.

72. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the general rule would remain that termination required documentary evidence. If there was to be an exception to that rule, it would have to be stipulated. The question of proof would then be a matter for the legal systems in question.

The meeting rose at 5.05 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 553rd MEETING

Held at the Vienna International Centre, Vienna,
on Friday, 5 May 1995, at 9.30 a.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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This record is subject to correction.

Corrections should be submitted in one of the working languages. They should be set forth in a memorandum and also incorporated in a copy of the record. They should be sent *within one week of the date of distribution of this document* to the Secretary of the Commission, room E0455, Vienna International Centre.

Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

V.95-58999 (E)

Distr.: 15 November 1995

The meeting was called to order at 9.30 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 11 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that it still remained to be decided whether to retain in paragraph (1) (c) of article 11 the words "unless the undertaking provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the undertaking".

2. After inviting comments regarding the deletion of those words, he noted that the representative of Japan would prefer to delete them but that the majority of the members of the Commission wished to retain them.

3. *Paragraph (1) (c) was retained without change.*

4. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the other point to be decided was the scope of paragraph (2), which some had found difficult to understand.

5. **Mr. MARKUS** (Observer for Switzerland) saw a contradiction between paragraphs (1) and (2). Confusion or fraud by the beneficiary might be the result in cases where the guarantor, pursuant to article 1 (a), received a statement of release from liability from the beneficiary when the original instrument had stipulated that only the return of the instrument would lead to a cessation of the undertaking. That situation could be avoided by adding in the fourth line of paragraph (2) a full stop after "payment" and deleting the words "either alone or in conjunction with one of the events referred to in subparagraphs (a) and (b) of paragraph (1) of this article". The paragraph would then continue: "However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with paragraph (1) of this article preserve any rights of the beneficiary under the undertaking", the words "subparagraphs (c) or (d)" being deleted.

6. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), referring to the first point made by the Swiss representative, said that there might be a need to make the link between paragraphs (1) and (2) clearer. Paragraph (2) spoke of the return of the instrument being the material consideration for cessation of the right to demand payment, while there was no such reference in paragraph (1).

7. The Swiss representative's second suggestion raised a substantive issue. In the current text, a distinction was made between the cases under paragraph (1) (a) and (b) and those under paragraph (1) (c) and (d). Under the Swiss proposal, all the situations under paragraph (1) (a) to (d) would be subject to the portion of the text reading "However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with paragraph (1) of this article preserve any rights of the beneficiary under the undertaking".

8. **Ms. FENG Aimin** (China) said that she would prefer to retain the wording of paragraphs (1) and (2), but that if it was changed, the same rules would have to be included in articles 8, 9 and 10. Another solution might be to redraft article 7 (2).

9. **Ms. ASTOLA** (Finland) thought that the confusion arose from the first sentence of paragraph (2). She supported the Swiss proposal. Paragraph (1) (a) and (b) depended on the wish of the beneficiary, whereas paragraph (1) (c) and (d) did not. The explanation in the first sentence of paragraph (2) was unnecessary if the return of the document to the guarantor/issuer was required for the cessation of the right to demand payment. It could not be required if the event referred to in subparagraph (c) or (d) had occurred.

10. **Mr. LAMBERTZ** (Observer for Sweden) considered the issue to be more one of legal logic than of policy. He too found it a puzzling idea that if the original undertaking required the return of the document and if later the beneficiary released the bank from its liability in a separate statement, or, as provided for in paragraph (1) (b), there was a subsequent agreement on the termination of the undertaking, the provisions of the undertaking should still prevail and not be cancelled by the release.

11. He agreed with the observer for Switzerland that some amendments were needed and suggested the inclusion of a new paragraph (1) (e) stating that the right to demand payment terminated if the undertaking stated when the document had to be returned.

12. **Mr. RADWAN** (Observer for Arab Association for International Arbitration) suggested that paragraph (2) should be redrafted to say that the return of the document was presumed to have effected cessation and was proof thereof unless there was evidence to the contrary.

13. **Mr. CHOUKRI SBAI** (Observer for Morocco) considered that paragraph (2) was not mandatory, but explanatory. It was unnecessary to go into such detail, and the parties should be left to choose whatever option was in their best interests. The last sentence of the paragraph was superfluous, since there was no point in keeping a document after the relevant time period had expired. If payment had been made, proof to that effect would exist. He therefore proposed that paragraph (2) should be deleted.

14. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that the Working Group had considered it important to stress in paragraph (2) that holding the document did not create the right to demand payment. In certain jurisdictions that was a point of contention, and it was therefore important to clarify the matter in the Convention.

15. **Ms. BAZAROVA** (Russian Federation) said that in her delegation's view the substance of paragraph (2) should be retained, although its drafting could possibly be improved. The proposed new paragraph (1) (e) did not make clear the voluntary nature of the return of the document embodying the undertaking, but appeared simply to describe an eventuality already provided for in paragraph (1) (a).

16. **Mr. SHISHIDO** (Japan), agreeing with the remarks made by the representative of the Russian Federation, said that his delegation preferred to keep the text of article 11 as it stood. Under the Swiss proposal, the parties no longer had the option of agreeing to make the return of the document part of the requirement for the cessation of the beneficiary's right to demand payment. Furthermore, a stipulation to the effect that the return of the document would by itself give rise to cessation presented difficulties. Such return merely constituted evidence, and it was difficult to regard it as an expression of the will of the beneficiary.

17. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) pointed out that the intention behind the proposed new paragraph (1) (e) was not to stipulate that the beneficiary's right to demand payment automatically ceased upon the return of the document embodying the undertaking, but rather to provide for a fifth event whereby that right would be terminated, subject to the parties' having so agreed in the undertaking. The beneficiary's right to demand payment would thus cease upon the first occurrence of one of the eventualities set out in subparagraphs (a) to (e). The Commission might perhaps wish to add a further paragraph, specifying that mere retention of the document following one of those occurrences did not have the effect of reinstating the undertaking.

18. **Mr. OGARRIO** (Mexico) suggested that the first part of paragraph (2) be redrafted to form the substance of a new paragraph (1) (e) and that the last part of paragraph (2) be retained and make reference to the first four subparagraphs of paragraph (1), but not to the new subparagraph (e), which would itself deal solely with cessation of the right to demand payment in the event of the return of the document, where such an agreement had been made between the parties.

19. **Mr. BOSSA** (Uganda) said that his delegation also supported the deletion of paragraph (2) and its partial replacement by a new paragraph (1) (e), which could perhaps be worded along the following lines: "If the document embodying the undertaking first stipulates that the document is returned to the guarantor/issuer. However, failure to return such document after the right to demand payment has ceased in accordance with subparagraphs (c) or (d) shall not preserve any rights of the beneficiary under the undertaking".

20. **Mr. ADENSAMER** (Austria) said that the proposed new paragraph (1) (e) did not satisfactorily deal with cases where, after it had been stipulated in the undertaking that the return of the document alone would give rise to termination of the right to demand payment, an adversarial situation arose, such as subsequent agreement by the guarantor/issuer and beneficiary regarding a different form of termination, as referred to in paragraph (1) (b). Which of those two arrangements would then apply? In his view, the more recent one should, since it constituted an amendment to the undertaking. He therefore supported the Swiss proposal.

21. **The CHAIRMAN**, speaking as representative of Singapore, said that, although he saw merit in the proposal to delete paragraph (2) and add a paragraph (1) (e), he shared the concern expressed by other delegations regarding the question of liability in cases where the document was retained. He therefore suggested that paragraph (2) should be kept but amended to read: "Where the right of the beneficiary to demand payment in accordance with paragraph (1) of this article has ceased, retention of the document by the beneficiary shall not preserve any right of the beneficiary under the undertaking".

22. **Mr. EDWARDS** (Australia) said that, while he could go along with the inclusion of the proposed paragraph (1) (e), that alone would not resolve the concern expressed by the representative of Austria. He thus suggested that a new paragraph (1) be drafted, stating that, if a stipulation was made in the undertaking to the effect that its termination could be effected only by the return of the document, then cessation would occur solely upon such return. Paragraph (2) would then provide for the other cases, i.e., where there was no such stipulation, and would state that termination would occur when one of the expiry events provided for in its subparagraphs (a), (b), (c), (d) and (e) arose, subparagraph (e) covering the eventuality of the simple return of the document. The new paragraph (3) would state that, if termination arose by reason of the occurrence of one of the events set out in paragraphs (2) (a), (b), (c) and (d), then retention of the document would not preserve any rights of the beneficiary.

23. **Mr. ILLESCAS** (Spain) said that the proposed amendments might affect the balance which the current wording of article 11 maintained with regard to guarantees. His own and many other countries applied the principle that guarantees were not negotiable instruments. The introduction of a new aspect at the end of the validity period of the undertaking might increase the weight of the documentary aspect of cessation to the detriment of its contractual aspect. It was not possible to regard the simple return of the document as constituting a discharge of liability, since that would give it the nature of a negotiable instrument. His delegation therefore preferred to retain the text of the article as it stood.

24. **Ms. CZERWENKA** (Germany), agreeing with the observations made by the representative of Finland, said that her delegation was in favour of retaining the substance of paragraph (2). If the parties stipulated that the return of the document was necessary for cessation of the beneficiary's right to demand payment, the will of the parties, as provided for in the proposed new paragraph (1) (e), would be overridden by the occurrence of the eventuality provided for in paragraph (1) (a), because the statement of release would be sufficient for cessation of the right to demand payment, regardless of the return of the document.

25. **Mr. SHIMIZU** (Japan) said that, if the undertaking stipulated that the return of the document alone would have the effect of terminating the undertaking, the parties could avail themselves of article 8 should they wish to amend that arrangement subsequently. A reference to that article might perhaps resolve the concern expressed by the representative of Austria.

26. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) suggested the following solution. Firstly, a new paragraph (1) (e) should be added, which would in essence state that where it was so stipulated in the undertaking, the right to demand payment ceased when the undertaking was returned to the guarantor/issuer. That would recognize the possibility for parties to stipulate that for the instrument to cease being available for payment, its return by the beneficiary to the guarantor/issuer was required. Secondly, language could be added to paragraph (2) to the effect that in no case should retention of the undertaking by the beneficiary after the right to demand payment ceased for any of the reasons set forth in subparagraphs (a), (b), (c) and (d) preserve any of the rights of the beneficiary under the undertaking.

The meeting was suspended at 10.50 a.m. and resumed at 11.20 a.m.

27. **Ms. ASTOLA** (Finland) asked whether, even under subparagraphs (c) and (d), retention of the undertaking was possible and the right to demand payment remained if it was stipulated that the undertaking must be returned.

28. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the proposed subparagraph (e) represented a new situation, which must be clearly circumscribed, as it was not a mere provision requiring the return of the instrument in view of termination. If that situation occurred before any of the situations described in subparagraphs (a), (b), (c) and (d), that brought the right to demand payment to an end. But if any of those situations occurred first, then mere retention did not give the right to demand payment. As to paragraph (2), that would have to be understood as meaning that if the return of the instrument occurred before any one of the situations described in subparagraphs (a), (b), (c) and (d), then the right ceased. His proposal would also mean that it was no longer a question of the situations described in subparagraphs (a) and (b) being coupled with the question of return. Basically, it would mean that if one were given an instrument which said that the undertaking was terminated, then it was terminated. There would be five possibilities operating distinctly.

29. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that the proposed addition of subparagraph (e) was a good change, but that the problem was not one of drafting. His delegation had been concerned by the fact that the document could be returned to the guarantor for a reason other than payment, such as correction of an error, in which case the beneficiary would retain it. However, it had been reassured by the explanation given by the Chairman of the Committee of the Whole that there would have to be an explicit reference to the fact that the document was being returned for payment. He asked whether the return of the document was definite proof of payment or whether the contrary could be proved by other means. If return was proof, wording could be added to the effect that the right to payment ceased unless the contrary was proved.

30. **Mr. MARKUS** (Observer for Switzerland) said that the proposal by the Chairman of the Committee of the Whole fully satisfied the concerns of his delegation and was an excellent way to resolve the problems.

31. **Mr. BYRNE** (United States of America) said the proposal did not meet the purpose of the first sentence of paragraph (2), which was to clarify that the second sentence did not mean that the prudent and sound practice of requiring the return of the instrument prior to its expiry signified an intent that the undertaking should be prematurely terminated. The idea of preventing the fraudulent re-use or circulation of the operative instrument was not included in the proposal by the Chairman of the Committee of the Whole. Instead, a new element was introduced in its place, which did either too much or too little. There was no need to address a situation in which the undertaking itself had a mechanism for termination by virtue of the return of the instrument, as that was covered by paragraph (1) (b). Any such provision would need to specify the reason for the return, as there were a number of situations in which a return might occur, but in a convention of the present sort to deal with a rather unusual situation which the parties had brought upon themselves was unnecessary and unwise.

32. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that the proposal by the Chairman of the Committee of the Whole would make things more complicated and left the question of payment open. He was satisfied with the present text, which would avoid any misunderstanding.

33. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) suggested that the idea of a subparagraph (e) should be dropped, that paragraph (1) should be left unchanged and that in the second sentence of paragraph (2) the words "subparagraphs (c) or (d) of" should be deleted.

34. **Mr. ILLESCAS** (Spain) said that while that change might be acceptable, it should be accompanied by the deletion in the first sentence of paragraph (2) of the words "either alone or" in order to clarify the situation. Those words did not fit with the imperative nature of paragraph (1), which seemed to establish means of cessation without allowing for other possibilities. None the less, the words "either alone or" created a fifth possibility consisting simply of the return, with which he disagreed. Paragraph (1) would then have a considerable bearing on paragraph (2), which would be an appendix to subparagraphs (a) and (b) of paragraph (1), but would not add any element to the issue of the right to demand payment.

35. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he took it that the Commission wished to retain article 11 as drafted.

36. *It was so decided.*

Article 19 (A/CN.9/408, annex)

37. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that article 19 was the only provision on which no consensus had been achievable in the Working Group. It was a key provision, because the whole area of bank guarantees, stand-by letters of credit and commercial letters of credit, which were otherwise extremely successful instruments, was plagued by the question of fraud and its effects.

38. **Mr. VASSEUR** (Observer for Monaco) said that articles 19 and 20 were the pillars of the Convention. Speaking on behalf of the Ministry of Foreign Affairs of Monaco and the Association of Monaco Banks and in the light of letters addressed to the Secretary in May 1993 and September 1994 by the Banking Federation of the European Union, he said that the Banking Federation was deeply disappointed that the draft Convention did not contain explicit provisions on counter-guarantees. It was especially disappointed that article 19 appeared to completely disregard the problem of fraudulent or otherwise improper demands, and in particular the counter-guarantee regime in such cases. The Banking Federation wanted a clear rule that a fraudulent or otherwise improper demand on the first guarantor did not render the counter-guarantee regime itself fraudulent. As a corollary, the counter-guarantee should only be regarded as abusive in the event of complicity between the beneficiary making its demand on unfounded, abusive or fraudulent grounds and the first banker calling on the counter-guarantee. The disappointment of the Banking Federation over the issue was particularly acute in that an earlier draft of article 19 had contained a provision regarding the counter-guarantee. That text had been examined at the seventeenth session of the Working Group in April 1992, and the Working Group had at the time expressly agreed that the issue of counter-guarantees should be covered by article 19. A working paper produced in Vienna in 1992 had also dealt with the subject. Nor had the Working Group, at the twentieth session in November 1993, called explicitly for the deletion of all provisions regarding the counter-guarantee. The Banking Federation urged the Commission to ensure that article 19 covered the counter-guarantee in the event of a fraudulent or otherwise improper demand.

39. The Banking Federation also reserved its position in regard to the wording of article 19 (1) (a) (iii), which defined a fraudulent demand as one that had "no conceivable basis". The wording implied that the guarantor/issuer was expected to ask itself whether the demand had a "conceivable basis", a form of words that was not compatible with a guarantee given "on simple demand". If the demand was consistent with the letter of guarantee, it was up to the banker to pay; it was not his job to ask questions. The present wording might compel the banker to undertake verifications, to check that none of the situations mentioned in paragraph (2) applied, before making the payment. It could put an end to guarantees based on simple demand, which were in fact the most common type of guarantee used throughout the world and which the Working Group itself felt should continue in use and be covered by the Convention. Furthermore, the wording used, with its reference to "no conceivable basis", seriously impaired the independence of the guarantee as enshrined in article 3 of the draft Convention. In consequence, the Banking Federation suggested that the first line of article 19 (1) (a) should read "if, in the view of the guarantor/issuer, it is manifest, clear and beyond any doubt that" and that paragraph (1) (a) (iii) should be deleted. It also took the view that paragraph (2) was not absolutely necessary, but that if, it was to be retained, the second part of the first line should read "the following are types of situations in which, beyond any doubt, no payment is due". The point was that it should be clear, manifest and beyond any doubt that the call for payment was fraudulent or otherwise improper.

(*Mr. Vasseur, Observer for Monaco*)

40. He was also dissatisfied with the title of article 19, which had been proposed fairly recently, after the previous title had been justifiably discarded. It should not lay the stress on the behaviour of the banker. In several countries, including France, Germany and Switzerland, recent case law had shown that if the banker wished to make a payment in such circumstances, he could do so, but that he could not request repayment on the part of the principal. It was the banker who gave his guarantee, and if, for his own reasons, such as the desire not to undermine his international credibility, he decided to pay, he should be free to do so. There existed blacklists of banks reputed to be poor payers, and the major European banks had no desire to be placed on such lists. A number of court decisions had been made along those lines in several countries. The words "good faith" in the last line of paragraph (1) (a) were also unsatisfactory, since the real point was whether the banker could reclaim repayment from the principal. In regard to the title, the original reference to abuse and fraud had, it seemed, disconcerted certain countries, especially those with common-law systems, which did not recognize the concept of abuse. The difficulty could be avoided by amending the title to "fraudulent demands and similar situations", in which the term "similar situations" would cover the question of abuse. There were also cases of *force majeure* in which the principal was prevented from executing his obligations; one such case was that of embargoes, which the Convention should not simply ignore.

41. He concluded by stating that the content of articles 19 and 20 as finally decided would determine the future attitude of the banks towards the Convention. Although it was not the role of UNCITRAL to please the banks or of the banks to please UNCITRAL, it had to be remembered that it was essentially the banks that gave guarantees, that article 1 of the Convention made provision for the possibility of exclusion, that it was usually the beneficiary that proposed the text of the guarantee and that it also had the possibility of imposing the exclusion of the application of the guarantee. Beneficiaries would not favour the Convention if it appeared to impair in any way the rigour of the guarantee. Correspondents of major European banks in the principal countries benefiting from guarantees had expressed very strong reservations in regard to articles 19 and 20, and the representative of the United States of America had warned against any provision that might impair the integrity of the argument. All those issues should be carefully considered in drafting such key articles of the Convention.

42. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that one of the difficulties throughout the process of drafting the text had been the diversity of definitions of fraud and abuse. That was why, after long discussion, a descriptive approach had been adopted in paragraph (1) (a). It would, in his view, be dangerous to return to concepts that were natural to some people because of their training but not to others. The aim must be to achieve consensus.

43. **Mr. SHISHIDO** (Japan) asked whether article 19 was mandatory or not and whether a party could agree to give the bank absolute freedom to pay or not to pay. If the article was not mandatory, it would not need to be discussed so seriously, but if it was, it would have to be worded very carefully. The whole structure of the article was based on the principle that when a demand was manifestly and clearly improper, no payment would be made, and the beneficiary could not seek damages against the guarantor/issuer and had no right to reimbursement. Problems would arise because of two exceptional cases that might occur involving misjudgement. In the first, the guarantor/issuer made a payment when he should not have done so. That payment would not be in good faith and the banker would not be able to obtain reimbursement from the principal. In that case, there was a difficulty with the wording of paragraph (1) (a), in which the phrase "in the view of the guarantor/issuer" was ambiguous and misleading. Despite the reasons given for that wording

/...

(*Mr. Shishido, Japan*)

in paragraph 70 of document A/CN.9/408, the terminology used suggested that the payment depended absolutely on the judgement of the guarantor/issuer, which was not the intention. He therefore proposed that the phrase "in the view of the guarantor/issuer" be deleted.

44. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he would invite the representative of Japan to conclude his statement at the next meeting.

The meeting rose at 12.35 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 554th MEETING

Held at the Vienna International Centre, Vienna,
on Friday, 5 May 1995, at 2 p.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Draft Convention on Independent Guarantees and Stand-by Letters of Credit (*continued*)

Article 19 (*continued*)

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Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

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Distr.: 15 November 1995

The meeting was called to order at 2.10 p.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408 and A/CN.9/411)

Article 19 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the Working Group had come to the conclusion that the terms "fraud" and "*abus de droit*" could not be used because they had so many different connotations, and that it was a better approach to describe certain circumstances under which payment would not be in good faith. That approach had been followed in subparagraphs (a) (i), (ii) and (iii) of paragraph (1). Similarly, paragraph (2) had given examples of situations in which a demand had no conceivable basis. The questions left open, on which the Commission should concentrate, were whether there should be an obligation not to pay, and, if so, what should be the mechanism for establishing such an obligation, or a right not to pay.

2. **Mr. SHISHIDO** (Japan) recalled that at the previous meeting he had proposed the deletion of the words "in the view of the guarantor/issuer" in paragraph (1) (a), because they might be construed as giving the guarantor/issuer absolute freedom of action. The reference to good faith established a link with articles 14 and 15, implying that the guarantor/issuer need not investigate the propriety or impropriety of documents.

3. His second proposal concerned the eventuality that, through misjudgement, a guarantor/issuer did not pay when he should have paid, after which he might be sued by the beneficiary and be ordered by the court to pay the amount stated in the undertaking, but could recover it from the principal/applicant. The question who would then have to bear the risk of payment of damages to the beneficiary caused by the delay seemed to be covered by paragraph (1) (b), but it could also be settled by means of an arrangement between the guarantor/issuer and the principal/applicant, so that paragraph (1) (b), including the passage in square brackets at the end, was superfluous and should be deleted.

4. **Mr. BYRNE** (United States of America) said that his experience of discussions on the substance of the article had shown that it was of critical importance and offered both an opportunity to do much good and a grave danger of producing an imbalanced product that would not be acceptable in the commercial world.

5. A workable system was in place in every country, involving sometimes positive law, sometimes the judicial system, and so on. Whatever the elements of the system, they must be in overall balance in order to enable commerce to function.

6. It was important to bear in mind the elements of the balance and the various interests of all the parties in the eventuality that conforming documents were presented but there was nevertheless an allegation of fraud. One interest was that of the beneficiary, who was entitled to payment unless there was proof of fraud. Secondly, there was the social interest that the guarantor/issuer should not pay when there was clear and manifest evidence of fraud.

7. The third interest was that of the guarantor/issuer, in cases where it was not manifest and clear that there was fraud but there was nevertheless some suspicion or a basis for reasonable suspicion of fraud. The guarantor/issuer should not be put in a position of being required by a court in one jurisdiction to pay the

(*Mr. Byrne, United States of America*)

beneficiary while a court in another jurisdiction ruled that it was not entitled to reimbursement although it had paid in good faith without clear and manifest evidence of fraud.

8. Finally, there was the interest of third parties, such as confirming banks, and innocent third parties which had in good faith presented documents without knowledge of fraud.

9. Unless those interests could be balanced, the instrument would not be workable and acceptable.

10. It seemed to him that agreement should be reached on four questions, without which it would be pointless to discuss the niceties of drafting.

11. First was the question of the risk that the bank undertook with regard to fraud, i.e. what was the role of the guarantor/issuer when fraud arose. Was it the duty of the guarantor/issuer to examine documents for their genuineness and was it obliged to bear the risk of fraud? The answer to that question would greatly affect the rule to be drafted. He suggested that it was the universal understanding of the international operations community that it was not the guarantor/issuer but the principal/applicant that bore the risk of fraud or falsified or forged documents. A letter of credit was not a cheque, the beneficiary was not a customer of the issuer or guarantor but a stranger. The issuer or guarantor had no way of knowing who the beneficiary was or whether its signature was genuine, much less of knowing whether any document presented or any signature on the document was genuine. The undertaking of the issuer or guarantor was to examine documents for facial conformity. That was reflected in article 15 of UCP and article 12 of URDG. Commercial mechanisms were available to protect against the risk of fraud, for instance, through insurance which could be obtained by the applicant. It was not the duty of banks to act as detectives of fraud, nor were they insurers. Their duty was limited to examination of facial conformity.

12. The second question was related to the ability of an issuer or guarantor to dishonour a presentation on grounds of fraud and to the consequences of dishonouring a presentation. Had fraud to be proven? What would happen if a presentation were dishonoured, in good faith, but fraud could not be proven?

13. The third question, assuming that the source of the suspicion of fraud came from the principal/applicant, was whether the guarantor/issuer could contract with the principal/applicant to indemnify the latter for the cost of raising the question of fraud. If a rule were established that there was a duty to dishonour, a question arose in the mind of his delegation and of the banking community of the United States of America whether *ordre publique* would prevent contracting for indemnification in such situations.

14. Finally there was the question whether or not there could be innocent third parties and, if so, what the effect would be.

15. It seemed to him that the first possible approach to that situation was not to speak to the question but simply to state grounds for non-payment despite facial compliance and set forth a general rule, without specifically indicating whether a duty, a right or a discretionary right existed with regard to payment.

16. The second approach was to predicate a duty to dishonour in specific situations. If that were to be acceptable, it would also be necessary to make it clear that there was a related right to indemnification.

(*Mr. Byrne, United States of America*)

17. The third approach was to indicate that, where the guarantor/issuer acted in good faith according to recognized standards of international practice in independent guarantees or stand-by letters of credit, it had the ability to dishonour where fraud was alleged and where it was not clear that there was in fact fraud. In that case, it must be prepared to prove such fraud in an action brought by the beneficiary.

18. It was essential to clarify those questions of principle in order to achieve a genuine consensus.

19. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that the article seemed to stress non-payment rather than payment. It was wrong to make "the view of the guarantor/issuer" a condition for payment or non-payment; the words "in the view of the guarantor/issuer" should be deleted.

20. He supported the proposal of Japan for the deletion of paragraph (1) (b).

21. He agreed with the third option outlined by the delegation of the United States and thought that it should be incorporated in the text as paragraph (3).

22. **Mr. FAYERS** (United Kingdom), referring to the four principles enunciated by the representative of the United States, said that he accepted the proposition that if there were clear evidence of fraud there would be no payment under the guarantee. The more difficult concept was in areas where there was suspicion of fraud, which again included two types of cases.

23. Though banks should not be obliged to act as detectives, there was a case covered by (1) (b) where the guarantor was put in possession of facts by its customer, which raised the question what action should be taken. It could not be permissible that the bank should turn a blind eye, but, if it accepted the information, the question arose as to the extent to which it must assess the information. That was a difficult area. Investigation of the matter by the bank would entail a monetary cost and also slow down the mechanism of the guarantee. However, there might well be cases in which, as a result of information put before a bank by its customer, it was or should be quite clear that there was fraud.

24. He asked whether the United States banking community would flatly refuse to make any investigation when presented with evidence of fraud and if so whether they would suggest that the customer go to court. Perhaps the representative of the United States would expand on its position with regard to such cases.

25. He quoted a case where the seller diverted a shipment to a port in a different country but presented the documents that named the original port. He found it difficult to believe that, if the buyer pointed out that it was merely necessary to consult Lloyd's list to establish the facts, the bank would then decline to make that simple examination. That area should be investigated further.

26. **Mr. LAMBERTZ** (Observer for Sweden) welcomed the remarks of the United States and agreed that a balance had to be struck between various interests. A bank had an obligation towards the beneficiary, i.e. an obligation to pay; it also had an obligation towards the principal, namely, not to expose the latter to the risk of losing money. That obligation would exist if the bank was certain that the beneficiary was not entitled to payment. It was therefore justifiable to incorporate the subjective element implicit in the words "if in the view of the guarantor/issuer it is manifest and clear that ..." in the article, though, at an earlier stage in the discussion of the question, he would have agreed with Japan.

(*Mr. Lambertz, Observer for Sweden*)

27. Though it was impossible either to prove or disprove a subjective assessment by a bank, balancing the interests of the two sides seemed to show that the rule was acceptable.

28. The proposed indemnification clause in paragraph (1) (b) could also be accepted, though he agreed with the Japanese delegation that the bracketed portion in the last lines of the paragraph should probably be deleted.

29. Taking up a point raised by the United States, he said that the Commission might discuss the inclusion in the Convention of a rule stating that in some instances the bank had a right not to make payment, when it was not sure whether there was fraud or not. That would be a right *vis-à-vis* the beneficiary, whereas the obligation not to pay was an obligation towards the principal. The right not to pay could exist when there was a high probability that the bank was under an obligation not to pay. He therefore favoured adding to the obligation not to pay a right not to pay.

30. He did not believe that it was desirable at the present juncture to discuss the question of innocent third parties — an extremely complex problem that went to the heart of national legislation. The provision in article 1 (1) which permitted opting-out from the Convention ought not to apply to articles 19 and 20.

31. **Ms. ASTOLA** (Finland) said that she shared the views put forward by the representative of Japan. It would be preferable to delete the words "in the view of the guarantor/issuer" but acceptable alternatives would be to make a reference to international banking practice at the beginning of paragraph (1) (a) or to take up the Japanese proposal of simply referring to articles 14 and 16. She shared the view that paragraph (1) (b) should be deleted and replaced by a form of words similar to that used in article 8 (3), stating that an amendment had no effect on the rights and obligation of the principal/applicant unless the latter consented to it.

32. The representative of the United States had said that there were three options before the Commission. In her view, however, a fourth possibility would be to avoid mentioning the idea of an obligation not to pay. It could be stated that the guarantor/issuer had a right not to pay in certain circumstances, mentioned in paragraph (1) (a), and that, if the guarantor/issuer chose to pay even when it had the right not to pay, that decision would have no effect on the principal/applicant unless otherwise agreed. Thus the question of indemnification would not be addressed in the article.

33. She did not think it would be possible to reach agreement that the guarantor must pay, whatever the eventuality. It would be more helpful to speak of a "right not to pay" and then link the protection of the principal/applicant to that right. She agreed with the observer for Sweden that the situation of innocent third parties could not be resolved in the article.

34. **Mr. KOZOLCHYK** (United States of America), speaking in answer to the questions raised by the representative of the United Kingdom, said that banks would generally not consult, say, Lloyd's list before deciding whether to make payment but would base their decision on actual documents.

(*Mr. Kozolchyk, United States of America*)

35. The problem perceived by the representatives of Finland and Japan seemed to be that the phrase "in the view of the guarantor/issuer", i.e. of the bank, appeared to be a subjective and somewhat arbitrary criterion, which explained Finland's preference for a discretionary right not to pay. But that discretion would be based on standards of international practice or good local practice, so that the type of situation in question must, firstly, be serious and, secondly, be manifest and clear, and the criteria concerned would be based on the actual documents. So long as there was a clear and manifest standard that could be objectively established relating both to letters of credit and bank guarantees, it would be reasonable to accept a bank's discretion or right not to pay.

36. **The CHAIRMAN**, speaking in his capacity as the representative of Singapore, agreed with the United States suggestion that the real issue was related to the bank's role when the question of non-payment arose. Agreement should be reached on that issue before attempting to find satisfactory wording for the article. In his view, it would be best to follow accepted international banking practice.

37. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the fundamental question before the Commission was one of policy — whether the guarantor/issuer had a duty or a right not to pay. Some speakers had suggested that it might be enough to state that in certain circumstances it would have a right not to pay or a discretionary power as to whether it should or should not pay. Other speakers had argued that, when an irregularity was "manifest and clear", payment must not be made. He pointed out that a right not to pay or to withhold payment had implications for article 20 on provisional court measures. Certain jurisdictions would insist that a request to the court to issue an order must be based on a definite obligation and not on a choice, as would be the case with a right not to pay.

38. **Mr. STOUFFLET** (France) referred to a distinction drawn by the Working Group between regulating merely the relationship between the guarantor and the beneficiary or including the relationship with the principal/applicant as well. In the first case, the word "may" would suffice. There would be no need for an obligation; the guarantor/issuer would merely have to justify its refusal to pay. In the second case, "may" would not be enough and there would have to be an obligation, with implications regarding the liability of the guarantor/issuer towards the principal/applicant. Ideally, the article should cover all cases but it might be preferable to take a more modest approach and leave the relations between the guarantor and the applicant to be determined by domestic law. That would be a realistic and logical approach, and would be consistent with what had been already decided.

39. **Mr. KOZOLCHYK** (United States of America), referring to the question whether non-payment should be a duty or a right, said that the representative of Iran had pointed out that the Convention stressed non-payment and that it should contain a statement to the effect that, once any agreed standards of examination had been complied with, the guarantor/issuer must pay. There would then be no problem with stating that, under certain circumstances, the obligation to pay imposed upon the guarantor/issuer could be suspended or revoked. Even if there were facial compliance of the documents, the guarantor/issuer could use its discretion based on other objective factors.

40. **Mr. OGARRIO** (Mexico) said he had the impression that the question whether there was a duty or a right not to pay had already been dealt with. He asked for distribution of the informal proposal made by the representative of the United States.

41. **Mr. BYRNE** (United States of America) said that his proposal had simply outlined some possible options.

42. **Mr. CHOUKRI SBAI** (Observer for Morocco) asked whether the guarantor/issuer automatically had the right to check the authenticity of documents or whether notice from the principal/applicant was necessary. If the guarantor/issuer were notified that the documents were fraudulent, it would be obliged not to pay. In practice, banks paid only after the authenticity of the documents had been thoroughly checked. He suggested that, since the title of article 17 was "Payment on demand", article 19 should simply be entitled "Non-payment". The reference to non-payment in the last line of paragraph (1) (a) might engender some confusion, especially in the Arabic version of the text, so that it might be preferable to choose a form of words to the effect that payment would not be made to the beneficiary if the guarantor/issuer considered that the falsification was manifest as described in subparagraphs (i), (ii) and (iii) of paragraph (1) (a).

43. **Mr. OGARRIO** (Mexico) said that the provision should establish a right rather than a duty not to make payment. He therefore suggested that the title of article 19 be amended and the wording of the last phrase in paragraph (1) (a) be changed from "payment shall not be made" to "payment may not be made", or words to that effect.

44. For the reasons stated by the French representative, paragraph (1) (b) could be deleted entirely; in his view, the Convention need not cover the relationship between guarantor/issuer and principal/applicant. If the possibility of compensation were included, a principal/applicant might agree to the compensation of issuing banks, thereby inviting the banks not to make payment.

45. **Ms. FENG Aimin** (China) pointed out an inconsistency between paragraph (1) (a), which gave the guarantor/issuer the right not to make payment in certain circumstances, and article 15 of UCP, which did not give banks such a right.

46. Moreover, article 19 contained no equivalent to article 18 (d) of the UCP rules, which read: "The Applicant shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages".

The meeting was suspended at 3.45 p.m. and resumed at 4.10 p.m.

47. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) suggested that the Commission should consider what the impact on provisional court measures in the various jurisdictions would be if the guarantor/issuer had the right not to pay. In his country, it was unlikely that provisional court measures would succeed if the bank had the right not to pay.

48. **Ms. BAZAROVA** (Russian Federation) said that the provision should establish a duty rather than a right. The guarantor/issuer had to be protected. Demand guarantees, which obliged the guarantor to pay the beneficiary, were rather dangerous because of their official nature and offered serious potential for abuse.

49. **Mr. BYRNE** (United States of America) outlined possible amendments to article 19, as follows:

The title of the article should read:

"Grounds for non-payment despite facial compliance of the documents";

(Mr. Byrne, United States of America)

Paragraph (1) should read:

"(1) (a) A ground for non-payment to the beneficiary despite the presentation of facially correct documents exists:

(i) any document is not genuine or has been falsified;

(ii) no payment is due on the basis asserted in the demand and the supporting documents; or

(iii) judging by the type and purpose of the undertaking, the demand has no conceivable basis."

A new subparagraph (1) (b) would reproduce the current paragraph (2), without any changes.

There were four possible options with regard to a new paragraph (2). The first would focus on a right not to pay and would read:

"If, in the view of the guarantor/issuer, with due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit, it is clear and manifest that a ground for non-payment pursuant to paragraph (1) (a) exists and for that reason payment would not be in good faith, the guarantor/issuer has a right not to pay."

The reference to paragraph (1) (a) was to the proposed revised wording.

The second option would be to retain only paragraph (1) and say nothing further regarding duties or rights.

The third option, based on the current approach in article 19 (1) (b), would be to link a duty not to pay with a contractual right to indemnification. In his delegation's view and in that of his country's banks, such a link was necessary. The text would read:

"(2) (a) If in the view of the guarantor/issuer, with due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit, it is clear and manifest that a ground for non-payment exists, pursuant to paragraph (1) (a) and for that reason payment would not be in good faith, it shall not be made to the beneficiary.

(b) Unless otherwise agreed, the principal/applicant will indemnify the guarantor/issuer against the consequences of dishonour at the request of the principal/applicant."

The fourth option would introduce a discretionary right. The text would read:

"Even if a ground for non-payment has been alleged, a guarantor/issuer acting in good faith with due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit may pay a beneficiary unless ordered otherwise by a court of competent jurisdiction."

50. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) noted that many delegations could accept the idea of a duty not to pay on certain conditions, such as indemnification, as suggested by the representative of the United States. He asked delegations to state whether they wished article 19 to be couched in terms of a duty or of a right.

51. **Mr. ILLESCAS** (Spain) said that if a guarantor concluded that payment should not be made because documentary requirements were not met or the documents were false, he was obliged not to pay. However, the situation differed when the guarantor did not arrive at such a firm conclusion or when a third party claimed that the documents did not conform and so informed the guarantor. In such cases, the guarantor had the right not to pay. When there was uncertainty, discretion should be allowed.

52. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that his request for comments on the question of duty versus right was related only to paragraph (1) (a), which, as currently drafted, restricted the possibility of non-payment to the three cases described in (i) to (iii) of subparagraph (1) (a).

53. **Mr. AL-NASSER** (Saudi Arabia) considered that the guarantor had both a right and a duty not to pay. Paragraph (1) (a) should begin with the words: "If the guarantor proves ...", instead of "If, in the view of the guarantor/issuer ...". In his country's legal system, a guarantor could not decide for itself whether a document was genuine or false: that had to be proved in court. Moreover, since the concept of good faith was construed differently under various legal systems, his delegation thought that the expression "in good faith" should not be used.

54. Paragraph (1) (b), requiring the principal to indemnify the guarantor, would run counter to practice in his country, where a guarantee was an obligation between a guarantor and a beneficiary. The guarantor, and not the principal, should apply for a judicial or arbitral determination that non-payment was justified.

55. **Mr. ILLESCAS** (Spain) said that the current wording of paragraph (1) (a), with its three sub-paragraphs, was not acceptable to his delegation. There should be no categorical establishment of bad faith in the event of the circumstances described in the three subparagraphs. There should be a reference to conduct in accordance with international standards.

56. **Mr. STOUFFLET** (France), referring to the use of the somewhat ambiguous term "discretionary" during the discussion, said that there was an element of arbitrariness in the French notion of "*discrétionnaire*". It would be wrong to convey the impression that in certain circumstances the guarantor/issuer was free to decide against payment. As he understood it, the practical implications of using either the word "shall", implying an obligation, or the word "may", implying an element of choice, did not differ greatly and the criteria to be applied by the guarantor/issuer were the same as those set out in articles 16 and 17. The word "shall", however, implied that the guarantor/issuer could be penalized for its behaviour, in certain circumstances.

57. **Ms. FENG Aimin** (China) said that she preferred the proposal put forward by the representative of the United States of America because the concept of a right might lead to abuse of rights by banks, whose credibility would suffer as a result.

58. **Ms. JASZCZYNSKA** (Poland) said that, as Legal Counsellor to the National Bank of Poland, she preferred, in practice, the concept of obligation in order to protect the bank as guarantor. That aspect was particularly important in the case of such instruments as independent guarantees with an international dimension.

59. **Mr. VASSEUR** (Observer for Monaco) said that formulating the question in terms of obligations and rights implied an underlying concern for the situation of the principal. Should the principal reimburse a guarantor who had made payment? The guarantor had issued the undertaking of its own volition and was not the principal's instrument in legal terms. Where the guarantor felt the need to pay in order to safeguard its international credibility, such conduct could not be held against it. With regard to the guarantor's entitlement to reimbursement, the instructions issued by the principal to the guarantor usually contained a clause permitting the latter, once payment had been effected, to debit the principal's account as a matter of course. The principal could then take action against the guarantor, on the understanding, however, that one of the basic principles of guarantee law was: pay first, contest later.

60. **Mr. CORELL** (Under-Secretary-General, The Legal Counsel), taking the floor at the invitation of the Chairman of the Committee of the Whole, said that the Commission was one of the many bodies served by the Office of Legal Affairs of the United Nations, which had very wide-ranging responsibilities. One of the current tasks of the Office was to assist in establishing the international tribunals set up by the Security Council for the former Yugoslavia and for Rwanda. Another was to provide services for the new organs being established following the entry into force of the United Nations Convention on the Law of the Sea. It was therefore virtually impossible to keep abreast of the substance of every activity under way in the bodies served by the Office.

61. The reports of UNCITRAL were referred to the Sixth Committee of the General Assembly, whose expertise was not, in his view, on a par with that of the Commission. The reports were therefore recognized as being more or less in a final state. It was important, however, to offer Member States an opportunity to comment on their content in the Sixth Committee.

62. When the report on UNCITRAL's current activities was submitted to the Sixth Committee, that Committee might decide to adopt it as it stood or to set up a working group to examine it prior to adoption, following which it would be submitted to the General Assembly. A diplomatic conference would not be necessary, as evidenced by the recent adoption by the General Assembly of the amendment to Chapter 11 of the Convention on the Law of the Sea or the Convention on the Safety of United Nations and Associated Personnel. It was a matter of convincing Governments that a text was sufficiently clear to allow its immediate adoption by the General Assembly.

63. He had been gratified to note the disciplined way in which the Commission went about its work. Such matters as the time when the meeting was called to order and the time at which it rose were placed on record and were noted by the Fifth Committee. It was important to show Member States that it was possible to work efficiently in the United Nations.

The meeting rose at 5.10 p.m.

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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Twenty-eighth session

SUMMARY RECORD OF THE 555th MEETING

Held at the Vienna International Centre, Vienna,
on Monday, 8 May 1995, at 9.30 a.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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Draft Convention on Independent Guarantees and Stand-by Letters of Credit (*continued*)

Article 19 (*continued*)

This record is subject to correction.

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Any corrections to the records of the meetings of this session will be consolidated in a single corrigendum, to be issued shortly after the end of the session.

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The meeting was called to order at 9.35 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 19 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the discussion on article 19 so far had shown that there existed in substance only two possible approaches, which might be called the "shall" approach and the "may" approach. Under the "shall" approach, where it was manifest and clear to the guarantor that, in view of the conditions stated in paragraph (1) (a) (i), (ii) and (iii), any payment made would be in bad faith, the guarantor must not pay. The alternative would be that, in the same situation the guarantor/issuer might — rather than must — refuse to pay. The exception to the obligation to pay a demand made in accordance with article 14 could therefore be expressed either by a prohibition limited to very specific circumstances, or by language that did not set out in detail the various types of fraud but merely indicated that in certain situations payment might be refused. He would caution those preferring the "may" approach against including all kinds of conditions, such as making the right to refuse subject to the view of the guarantor/issuer or to the question of bad faith, as such restrictions might make matters less clear. He invited speakers to indicate their preference for one of those two approaches without going into great detail.

2. **Mr. BYRNE** (United States of America) said that, after consulting his Government and the banking community, his preference was for a formulation based on a right to withhold payment to the beneficiary. If his suggested formulation was adopted, there would be no need to refer to a contractual right to indemnification in the text, since there would be an understanding between the parties that such a right, though not mentioned, would be available. The formulation he proposed was as follows: "If, in the view of the guarantor/issuer, acting in good faith and with due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit, it is clear and manifest that a ground for non-payment exists, the guarantor/issuer has a right to withhold payment to the beneficiary". A reference to where such grounds for non-payment were formulated in the text would be inserted as appropriate. The suggested approach combined a number of useful elements, including good faith, generally accepted standards of independent guarantees and stand-by letters of credit, the "manifest and clear" requirement, the right to withhold payment and the restriction of the scope by the words "to the beneficiary". Though the other approach would if necessary be acceptable, he felt that the one he suggested represented a useful compromise.

3. **Mr. EDWARDS** (Australia) considered that the suggestions so far put forward in connection with article 19 did not deal entirely satisfactorily with the matter of central concern to bankers, namely, that article 19, as currently drafted, did not provide sufficient certainty to encourage the financial community to support the Convention. The banking community in Australia was particularly concerned that the grounds set out in paragraph 1 (a), by requiring too broad a range of judgements by the guarantor, would make his position untenable. If the necessary documents were presented in proper fashion, the guarantor should be required to pay, except in the case of fraud to which the beneficiary was a party. The banking community was also concerned about the effect upon the assignee's position: when the latter demanded payment, he should not be met with some defence referring to wilful misconduct or fulfilment of the underlying obligation. Though the bankers' views should not be regarded as determinant, they drew attention to the fact that article 19 should not be so broad-ranging and conducive to uncertainty that it weakened the fundamental obligation referred to in article 17, namely, that a demand made in accordance with the provisions of article 14 would, in normal circumstances, result in immediate payment. Accordingly, the debate as to

(*Mr. Edwards, Australia*)

whether article 19 should deal with a right or an obligation not to make payment should not detract from the more important need to achieve a sufficient degree of certainty to safeguard the integrity of the obligation specified in article 17. If the grounds for non-payment could be defined with maximum certainty, they could be backed up by a requirement that payment must not be made in such circumstances. If, on the other hand, such a degree of certainty could not be achieved, the Convention might have to make the right to refuse payment discretionary, as in the United States proposal. In short, the choice of approach would depend on whether greater certainty could be achieved in the grounds mentioned in article 19 (1) (a) than was at present the case.

4. **Mr. SHISHIDO** (Japan) said that, in his view, there was only one possible approach to article 19, but various ways in which it could be expressed. If the demand was manifestly and clearly improper, the guarantor/issuer had a duty not to pay the principal/applicant, but a right not to pay the beneficiary. That requirement could be expressed in various ways. The word "shall" could be used, as in the current text, suggesting that it was a duty not to pay. It would also be satisfactory for the guarantor/issuer to have the right not to pay, or, to use the terminology suggested by the representative of the United States, to withhold payment. But it should be made perfectly clear that such a right applied in relation to the beneficiary and not the principal/applicant.

5. **Ms. CZERWENKA** (Germany) said that it was vital to distinguish between two different relationships, that between the principal/applicant and the guarantor/issuer, and that between the guarantor/issuer and the beneficiary. The Working Group had concluded that the former should be taken into account as well as the latter. One important consideration for her delegation was that the rights of the principal/applicant were also dealt with in article 20 on provisional court measures. Article 20 would not make sense if the rights of the principal/applicant were not dealt with as they now were in article 19. It was helpful to have a rule under which the principal/applicant had a right with respect to the guarantor/issuer and could require him not to pay. Regarding the substance of paragraph (1), the criteria it set out were highly restrictive. In particular, the guarantor/issuer would, in her delegation's view, have no obligation to make investigations; the fact that payment would not be in good faith must be "manifest and clear". There should therefore be no serious problems in applying the text, and Germany considered it acceptable as it stood.

6. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that, as he understood it, acceptance of article 19 as it stood entailed acceptance of both paragraph (1) (a) and paragraph (1) (b).

7. **Ms. CZERWENKA** (Germany) said that Germany could accept the rule on indemnification in subparagraph (b) since, as a whole, it complemented subparagraph (a).

8. **Mr. VASSEUR** (Observer for Monaco) said that too much attention should not be paid to the relationship between the guarantor/issuer and the principal/applicant, since the obligation entered into by the guarantor/issuer was his own. Although the undertaking was made at the request of the principal/applicant, it was entered into by the guarantor/issuer. Any other view would considerably weaken article 19. He therefore urged that the proposal submitted by the United States be adopted.

9. **Mr. ADENSAMER** (Austria) said that in his view, the clearest solution would be to leave article 19 as it was. Following the comments made by the representatives of Japan and Germany, he could go along with the United States proposal, though it needed to be made perfectly clear that the option to "withhold payment" applied only in regard to the beneficiary. The obligation to withhold payment in the relationship between the principal/applicant and the guarantor/issuer must remain.

10. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that on balance he considered that withholding payment should be a right, as in the United States proposal, rather than an obligation. That right would have to be exercised in the context of certain specified criteria and, in the event of abuse, the guarantor/issuer would be responsible for paying an indemnity to the beneficiary. The right also gave discretionary authority to the guarantor/issuer, who was responsible for any decision he might take.

11. **Mr. LAMBERTZ** (Observer for Sweden) said that the Swedish Government and banking industry were in favour of the "shall" approach, since they considered that whatever was stated in the Convention, the principle not to pay under certain circumstances would always exist. The process of drafting the Convention had been initiated because of the need to cope with the problem of improper payments. He therefore failed to understand the argument that the "shall" approach would create uncertainty for the banks. How could a rule on the obligation not to pay create greater uncertainty than no rule at all? Moreover, in view of the close links between articles 19 and 20, adopting the "may" approach would mean redrafting article 20.

12. There was also the problem of the words "unless the undertaking excludes the application of the Convention" in article 1 (1). If the "shall" approach was adopted, he believed it would be impossible to allow that part of the Convention to be excluded even if the parties to the undertaking chose to exclude the rest.

13. **Mr. HERRMANN** (Secretary of the Commission), referring to the last point raised by the observer for Sweden, said that the exclusion of the Convention as envisaged in article 1 (1) was quite different from the exclusion of certain of its provisions. If the Convention were excluded, there would be another applicable law, which might have a rule on the duty or right to refuse to pay. For the Convention to state that there were mandatory provisions in it so important that national law could not be substituted for them would create tremendous problems. There should be a provision to make it possible to exclude the Convention *in toto* and use another legal system instead at the choice of the parties. But the Secretariat would strongly advise against trying to impose one or two provisions on what would otherwise be a consistent legal system, namely, the law that would otherwise apply.

14. **Mr. ILLESCAS** (Spain) pointed out that there were already three important provisions in the Convention covering the obligations of the guarantor/issuer, namely, articles 14 (2), 16 (1) and 17 (2). Discussion as to whether articles 19 and 20 could be considered separately from one another was therefore superfluous. Articles 14, 16 and 17 made it clear that the guarantor/issuer had to pay in conditions of good faith and that if he did not, the rights of the principal were not affected. Article 19 therefore only had to deal with the possibility of a fraudulent demand for payment, and in that respect the United States proposal was clearer than the present complicated wording of article 19, which, if it were kept, should be made shorter and include a reference to articles 14, 16 and 17.

15. **Mr. STOUFFLET** (France) supported the United States proposal for the wording of paragraph (1) (a). He would, however, suggest that instead of saying that in certain circumstances the guarantor/issuer need not pay, it might be better to say that in certain circumstances the beneficiary did not have the right to be paid. That would then leave it open for the guarantor to pay up in the end if he so wished, even if the beneficiary did not have the right to demand payment.

16. He had serious reservations about paragraph (1) (b), which implied that the principal/applicant would have control over the execution of the payment. That would run counter to the very nature of the independent guarantee, which assumed that the guarantor was going to be independently liable.

17. **Mr. LAMBERTZ** (Observer for Sweden), referring to the statement by the Secretary, said that from the standpoint of the national legislator, it was incorrect to say that the question of the mandatory nature of the Convention was quite different from that of the various articles. If the Convention became national law, the question of which rules were to be mandatory would have to be clarified. He asked if the phrase in article 1 (1) "unless the undertaking excludes the application of the Convention" meant that there would have to be a reservation by countries that wanted the whole system mandatory.

18. **Mr. HERRMANN** (Secretary of the Commission) said that his understanding was that it was for those drafting and adopting the Convention to take a position on whether it should be mandatory or not. The current view as reflected in article 1 (1) of the draft Convention was that the Convention was not a mandatory regime and that countries could opt for another one. That issue was, however, very different from the question of which of the provisions of the Convention might be derogated from by the parties once the Convention was in force. In undertakings that were not international, domestic law would apply, but for the international regime a decision on which provisions should be mandatory had to be taken. He stressed the danger of trying to make only certain provisions of a convention mandatory, which would amount to imposing provisions on any other legal system that might be applicable.

19. **Ms. BAZAROVA** (Russian Federation) wished to retain the idea of the mandatory nature of the obligation not to make payment. The text could perhaps be made clearer by taking the United States proposal and replacing the "may" element by a "shall" element. She supported the retention of paragraph (1) (b) but shared the reservations expressed by the French representative: the independent nature of the undertaking should not be called into question in any way.

20. **Mr. KOZOLCHYK** (United States of America) said that while at one point a bank had a right to withhold payment or to pay as it chose, the moment it acquired knowledge of the existence of a fraud it had a duty not to pay. There was therefore little sense in trying to separate rights and obligations as if they were alternatives; they were two sides of the same coin.

21. The implications of making it an obligation for the guarantor not to pay had not been fully considered. How long would the obligation last? Would it mean that during a certain period the obligation remained a possible cause of action? If that cause of action was regulated by national law, what was that law's statute of limitations? What were the rights of the parties to the transaction while the obligation not to pay remained unresolved? Uncertainty would arise as to when the obligation not to pay ceased to exist as a cause of action.

(Mr. Kozolchyk, United States of America)

22. Since work on the Convention has first been begun, there had been a change of attitude on world markets. Both banks and beneficiaries had come to realize that it was not in their interests to insist on too literal an interpretation of the instruments to which they were parties. To adopt the position that the Convention's sole purpose was to ensure that abusive demands were not made would be as bad as to adopt the position that it had no purpose but to ensure finality of payment. European, United States and Australian banking associations had all indicated at various sessions of the Commission and the Working Group that they could not accept some of the articles, definitions and terminology of the draft Convention, which would be contrary to their practice. It was thus necessary to find a compromise, and one now seemed to be emerging on his delegation's proposal.

The meeting was suspended at 11 a.m. and resumed at 11.25 a.m.

23. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), summing up the discussion, said that the proposed amendment of article 19, whereby the obligation of the guarantor/issuer not to make payment would become a discretionary right to withhold payment, had apparently caused some delegations misgivings, in view of its possible effect on the position of the principal/applicant and on the matter of provisional court measures. In an attempt to accommodate those concerns, the Commission might wish to consider whether all the elements of the proposed new formulation were necessary or relevant, and also whether the question of penalties imposed in cases of fraud would have an impact on court measures. The current text of article 19 was restrictively worded, and he did not believe that it would open up wide opportunities for banks to challenge the need to make payments, as some delegations seemed to fear.

24. **Mr. FAYERS** (United Kingdom) wondered whether in the text of the United States proposal the phrase "with due regard to general accepted standards of international practice ..." sought to convey anything beyond what was expressed in article 13, paragraph (2). Was the intention to alter the scope of the obligations devolving upon the guarantor/issuer? If their scope were widened, there would be greater justification for adopting the discretionary approach and for accordingly stipulating that the guarantor/issuer had a right not to effect payment.

25. **Mr. KOZOLCHYK** (United States of America) said that the phrase in question had been inserted to meet the Finnish representative's desire for objectivity, with a view to limiting the guarantor/issuer's discretionary power.

26. **Mr. OGARRIO** (Mexico) said that his delegation felt that the term "withhold payment" would be preferable to "refuse payment", not only in the body of article 19 but also in its title.

27. With regard to the imposition of penalties in cases where the guarantor/issuer effected payment in bad faith, the relationship between the guarantor/issuer and the principal/applicant should not, in his delegation's view, be over-emphasized in the Convention. The reference to that relationship in article 20 in connection with exceptional circumstances was acceptable. However, it was more appropriate for the question of penalties for breaches of obligations to be dealt with in the contract between the issuing bank and its customer.

28. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that his delegation had been anxious from the outset that the Convention should safeguard the interests of the beneficiary, or at least the independence of the guarantor/beneficiary relationship. The emphasis should be on non-payment rather than payment. Exceptional cases involving fraud should be left to the jurisdiction of the courts. For the sake of balance, however, he could agree that the guarantor/issuer should in manifest and clear cases have some ground for non-payment, as provided for in the United States proposal.

29. **Ms. FENG Aimin** (China) said that she knew of no actual instances where banks had initiated non-payment measures in their daily transactions. Such steps would be implemented by a bank only after it had received a court order. Her delegation did not feel that the guarantor/issuer should possess the right to decide whether or not payment should be effected. That decision was the responsibility of the courts.

30. **Ms. CZERWENKA** (Germany) said that the main purpose in defining the situations constituting improper demands in article 19 (1) was to explain under what conditions the principal/applicant could intervene. If the text of that article was amended to allow the guarantor/issuer to refuse payment, that would mean admitting other possible instances of improper demands and, in view of the current formulation of article 20, would prevent the principal/applicant from applying for a provisional court order. Her delegation therefore preferred to retain the approach adopted in the existing wording of article 19.

31. **Mr. BONELL** (Italy), endorsing the views of the representative of Germany, said he had two additional remarks. In the opening line of paragraph (1), he would prefer that the phrase "in the view of the guarantor/issuer" should be deleted, which might meet the concerns of the representative of China. In addition, in paragraph (1) (a) (iii), the phrase "and for that reason payment would not be in good faith" should also be deleted, in order to avoid any misunderstanding, as the situations referred to in paragraph (1) did not cover all cases where payment would not be in good faith. According to article 14, it was the duty of the guarantor/issuer to act in good faith, and that covered a much broader spectrum than the situations described in paragraph (1).

32. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said there were two possibilities. One was to keep the present text, perhaps deleting the phrase "in the view of the guarantor/issuer" as being too subjective: if the facts were manifest and clear, they should be so to anybody. As to the matter of paragraph (1) (a) (i), in certain countries the author of the falsification must be the beneficiary, but that was not the case in many others. The Working Group had therefore felt that the restriction to falsification by the beneficiary should not be retained. Concerning the question of whether the reference to good faith was necessary, in certain jurisdictions that was in fact the test, whereas in others it simply sufficed that the grounds for non-payment be manifest and clear. The Group had therefore considered that, for the purposes of the Convention a combination might be required, under which the situation must be manifest and clear and must also be one in which, for that reason, payment would not be in good faith. That was new language which had been very specifically coined for the present Convention.

(Mr. Gauthier, Chairman of the Committee of the Whole)

33. The other option was to say that where the issuer was in good faith and where it was manifest and clear to that issuer that any of the three circumstances described in paragraph (1) existed, then that guarantor had a right to withhold payment to the beneficiary. As suggested earlier by the representative of Finland, a sentence could be added to the effect that that rule did not affect the rights that the applicant might have under its arrangement with the bank, nor the right the applicant might have to seek relief under article 20. The idea was to show clearly that the right to withhold arose solely within the context of the guarantor/beneficiary relationship, and that other relationships were not affected either in contractual terms or with regard to an applicant's ability to seek provisional measures from a court. To sum up, the Commission should choose to focus either on the right to withhold, making it clear that it did not affect the applicant/guarantor relationship, or on the fact that in certain manifest and clear circumstances the guarantor must not pay, although if the applicant had helped to bring those circumstances to the knowledge of the guarantor, then he assumed the risks by indemnifying the guarantor.

34. **Mr. FAYERS** (United Kingdom) said that he agreed with the suggestion by the representative of France that the last line of paragraph (1) (a) be inverted. As now worded, it required the guarantor to concentrate on whether what he was doing was in good faith. Rather, he should concentrate on whether the beneficiary was making the demand in good faith. The wording could be replaced by something along the lines of "and for that reason the claim by the beneficiary is not in good faith". That might make it easier for some delegations to accept the mandatory approach.

35. **Mr. AL-NASSER** (Saudi Arabia) said that the main difficulty seemed to be that the Commission was concentrating on protecting the issuer and the applicant, while not taking due care of the beneficiary. In articles 14, 17, 19 and 20, it was a question of the beneficiary being engaged in falsification or negligence. With regard to such cases the criteria in all letters of credit required that if falsification was proved, a civil case could be brought against the beneficiary in order to recuperate what had been paid unduly. However, the beneficiary could also be the injured party. In Saudi Arabia, for example, which was a consumer of letters of credit, there were numerous problems, as most banks that guaranteed applicants were foreign ones. When a claim was presented or a demand made, they tended to look for reasons for non-payment. He cited the case of a banking consortium which had issued a letter of credit to guarantee the implementation by a number of companies of specific projects in Saudi Arabia. When, however, the State had wished to cash the letter of credit, the banks had tried to find fault with the criteria it contained, in order to avoid making payment. The principle of sovereignty required the consortium to abide by the law of the land under which the letter of credit had been issued. It had in the end admitted its mistake and paid what it was required to pay. None the less, that example illustrated the problems of the beneficiary, which the Commission in its present discussion was neglecting in favour of those of the issuer. A satisfactory solution would be one which guaranteed the rights of both parties.

The meeting rose at 12.30 p.m.